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**GUIDE TO COMPANY BALANCE SHEETS
AND PROFIT AND LOSS ACCOUNTS**

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BOOK-KEEPING RAPID COURSE.
GUIDE TO EXAMINATION SUCCESS.
THE NEW ACCOUNTING REQUIREMENTS
FOR COMPANIES.
JORDANS' MODERN BOOK-KEEPING
(PARTS 1 AND 2).
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THE NEW REQUIREMENTS FOR COM-
PANIES AFFECTING SECRETARIES AND
DIRECTORS.
THE GROUP ACCOUNTS OF HOLDING
COMPANIES.

In Preparation :

THE STUDENT'S GUIDE TO COMPANY LAW.
ONE THOUSAND QUESTIONS AND
ANSWERS ON COMPANY LAW.

GUIDE TO COMPANY BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS

BY

FRANK H. JONES

F.A.C.C.A., A.C.I.S.

FOR DIRECTORS, ACCOUNTANTS,
INVESTORS, AND STUDENTS

FOURTH EDITION

(Completely Revised)

CAMBRIDGE

W. HEFFER & SONS LTD

FIRST EDITION	-	-	-	-	1938
SECOND EDITION	-	-	-	-	1946
REPRINTED	-	-	-	-	1947
THIRD EDITION	-	-	-	-	1948
FOURTH EDITION	<i>(Completely revised)</i>				1951

Printed in Great Britain at the Works of
W. HEFFER & SONS LTD., CAMBRIDGE, ENGLAND

ACKNOWLEDGMENTS

I acknowledge with grateful thanks the co-operation of the executives of several companies who have permitted me to refer to their accounts, etc., and to others who have, in addition, raised no objection to the reproduction of accounts and statements issued by their companies.

To the Editors of *The Accountants Journal*, *The Secretary* and *The Secretary's Journal*, who have allowed me to draw material from articles I have contributed to these journals since the publication of the third edition, I tender my sincere thanks.

Lastly, but by no means least, I am indebted to the many readers—directors, secretaries, accountants, reviewers and students—whose encouraging comments on previous editions have fortified me in the heavy task of bringing up to date the present edition.

FRANK H. JONES.

PREFACE TO FOURTH EDITION

Since the publication of the Third Edition much experience has been gained by accountants and secretaries in the practical application of the new accounting requirements for companies contained in the Companies Act, 1948. This edition has been enlarged to include not only all the new provisions which relate directly and indirectly to balance sheets and profit and loss accounts, but also the problems that have arisen in their application and the manner and extent to which these problems have been resolved.

Those issues which still remain controversial (e.g. the disclosure of turnover and cost of sales, the measurement of true profit, the accounting relevance of the effects of inflation, bonus issues, dividend limitation, the treatment of taxation in accounts, etc.) are discussed at some length.

While all chapters have needed revision in the light of current practices and prevailing conditions, those dealing with aspects of the subject upon which the law was (until 1948) almost silent, i.e. profit and loss accounts and the group accounts of holding companies, are considerably enlarged. The section on group accounts has been entirely re-written.

Two new phases which cannot be disassociated from balance sheets and profit and loss accounts are introduced. One—*Directors' Reports and other contacts between Boardroom and Shareholders*—is nowadays inseparable from the subject of published accounts, since the Act permits certain information to overflow into statements annexed to the accounts and the accounts in some instances form part of a descriptive brochure relating to the company's activities.

The other—Simplified Accounts—is a comparatively new technique. There is unmistakable evidence that accountants, having overcome most of the difficulties of presenting information required by the Act, are now devoting more attention to simplification of the final results so that their work may be better understood and appreciated by the layman. This will go a long way towards meeting the criticism which is at present levelled against the published accounts of companies in general.

The Appendices are completely re-set. Appendix A contains all the sections and schedules of the 1948 Act likely to be referred to by readers in using this book and these are included for convenient reference. The recently published accounts of prominent companies reproduced in Appendix B, not only illustrate the text, but provide some excellent examples of the design of balance sheets and profit and loss accounts, including consolidated statements, prepared in accordance with the new requirements and in some respects going beyond the provisions of the Act in the presentation of the requisite "true and fair view."

Since 1942 the Institute of Chartered Accountants in England and Wales has issued a number of important recommendations on accounting principles. These recommendations, made with a view to a greater measure of uniformity and informativeness in company accounts, may be accepted broadly as indications of the best modern accounting practices. The suggestions made by the Institute, which have been widely adopted by companies, are, where appropriate, included in this book.

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CHAPTER I

INTRODUCTION

LEGISLATION UP TO 1947.

Joint stock companies have existed in this country for over three hundred years. Among famous early companies to be formed were the East India Company (1600), followed some years later by the New River Company, the Hudson Bay Company (1670), and the Bank of England (1694).

It was not until 1844, however, that companies could obtain incorporation otherwise than by a Special Act or by Royal Charter, while the privilege of limited liability was first introduced with the Act of 1855. The law relating to companies was codified in 1862, some sixteen amending Acts being passed during the following 46 years, when the law was consolidated in the Companies (Consolidation) Act, 1908.

The Act of 1908 was an important and comprehensive piece of legislation. It contained 296 sections and six schedules, and came into force on 1st April, 1909, when it became possible, for the first time, for private companies to be incorporated.

Apart from short and relatively unimportant amending Acts passed in 1913 and 1917, the Act of 1908 continued in force for over twenty years, a period marked by the most profound changes in our national life and economic structure.

During this period a number of proposals were made to amend the law. In 1918 a Committee was appointed by the Board of Trade to consider what amendments to the Acts of 1908 to 1917 were expedient having regard to circumstances arising out of the 1914-18 war and possible developments on the termination of hostilities. No drastic changes were recommended as the Committee considered these might impede post-war reconstruction (a view that was not taken at the end of the second world-war!).

Then followed the boom period, when the number of companies appearing on the Register increased with astonishing rapidity, private companies in particular increasing by leaps and bounds.* Amalgamations of companies with allied or

* Statistics showing increases in the number of private companies in recent years appear on page 216.

competitive interests became common, and this practice gathered impetus as time went on. Such terms as holding companies, parent companies, subsidiaries, group and consolidated accounts, etc., were almost unknown when the Act of 1908 was passed.

It is a matter for little wonder that insistent demands were made for such amendments of the then existing law as would bring it into harmony with current practice. A Board of Trade Committee was appointed in January, 1925, under the chairmanship of Mr. Wilfrid (now Lord) Greene, K.C., to consider and report to the Board such amendments as were thought to be desirable. The Committee made its report, recommending a large number of amendments in, and additions to the law as embodied in the Companies Acts of 1908 to 1917.

Almost all the recommendations were adopted in the Companies Act, 1928, an Act containing 118 sections and several long schedules.

The Act of 1928, with the exception of one section, relating to share-hawking, never came into force, but the entire Act, together with the Acts of 1908 to 1917, as amended by it, were contained in the Companies Act, 1929.

In this manner the Companies Act, 1929, was born. It was a consolidating Act and in itself introduced no new law, but its operation initiated the considerable changes contained in the 1928 Act and imposed a large number of new obligations upon companies.

During the next decade—to the outbreak of the second world-war—developments and experience revealed the inadequacies of the 1929 Act in the light of conditions which had changed considerably.

THE COHEN REPORT.

In June, 1943, another Board of Trade Committee was appointed "to consider and report what major amendments are desirable in the Companies Act, 1929, and, in particular, to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest." The committee, which sat under the chairmanship of Mr. (now Lord) Justice Cohen, issued a questionnaire to various organisations and individuals. It held 47 meetings, at 26 of which oral evidence was heard

from professional bodies, stock exchanges, chambers of commerce, industrial associations, trade unions, public officials and private individuals. Its report, the *Report of the Committee on Company Law Amendment** (usually referred to as "The Cohen Report"), was issued in June, 1945.

The committee expressed itself as being satisfied by the evidence that the great majority of limited companies, both public and private, were honestly and conscientiously managed. It believed that the system of limited liability companies had been and was beneficial to the trade and industry of the country, but considered that the fullest practicable disclosure of information concerning the activities of companies would lessen opportunities for abuse and would accord with a wakening social consciousness.

Accordingly, while keeping in mind the importance of not placing unreasonable fetters upon business which is conducted in an efficient and honest manner, it made proposals to ensure that as much information as is reasonably required should be made available both to shareholders and creditors of the companies concerned and to the general public. The committee also sought means to make it easier for shareholders to exercise a more effective general control over the management of their companies. It emphasised, however, that this objective would be attained more by selection by the shareholders of the right governing body for each company than by the provisions of any statute.

The committee recalled in its report that in the early days of joint-stock companies, investors were usually people of wealth who had knowledge of and experience in financial matters; or else their affairs were administered by advisers who had such knowledge and experience. In the last hundred years there has been a great redistribution of wealth, so that many small investors have holdings in companies. This tendency is growing at the present time and the number of shareholders is likely to increase further, with a corresponding diminution in the size of the average shareholding.

Statistics are reproduced in the Cohen Report which illustrate how numerous are the shareholders in big companies and how small the average shareholding is. The committee also pointed out that the growth of investment trust companies and of unit trusts in recent years had tended to divorce the investor

* H.M. Stationery Office, Cmd. 6659, 2s. od. net.

still further from the management of his investments. Executive power must inevitably be vested in the directors and it is generally used to the advantage of the shareholders. The committee considered it desirable, however, to devise provisions which would make it difficult for directors to secure the hurried passage of controversial measures and, as far as possible, to encourage shareholders carefully to consider any proposals required by law to be put before them by the directors.

The report was of exceptional clarity, containing reasoned judgments and balanced recommendations. A debt is due to all concerned in the Committee's deliberations, including the representative bodies and individuals who gave evidence before the Committee. No serious student of company accounts or company law should neglect reading the report, which is still on sale.

Although the report had no legislative effect, the then President of the Board of Trade, Sir Stafford Cripps, stated in October, 1945, that the Government had adopted the proposals in their entirety and intended to introduce legislation to give effect to them. He advocated *that companies should, as far as possible, conform to the Cohen Report in advance of legislation* and many companies did so in so far as their published accounts were concerned.

THE COMPANIES ACT, 1947.

On 5th December, 1946, a Companies Bill was introduced in Parliament. The Bill embodied the proposals of the Cohen Committee, with certain modifications and additions. It was a non-political measure and its passage through Parliament was characterised by debates of a high standard, particularly some of those in the House of Lords. The President of the Board of Trade, in moving the second reading of the Bill in the House of Commons on 6th June, 1947, said "This tightening up of the company law in no way reflected upon the high standard of British enterprise, which was so largely carried on under the aegis of the Company Acts. The Bill would be of great benefit to the future of the business community of this country and would still further enhance the high reputation for honesty and fair dealing which British commerce and industry held and had held throughout the world."

The 1947 Act received the Royal Assent on 6th August, 1947. Certain concessions and alleviations in the Act and sections dealing with duties placed upon the Board of Trade, such as investigation into the affairs of companies and share or debenture ownership came into force on 1st December, 1947. Most of the provisions, including those affecting accounts, which are largely self-contained, did not come into force until 1st July, 1948 (the day after the passing of the consolidating Act of 1948), the promised notice of more than six months having been given in November, 1947. Most of the provisions examined in this book have accordingly operated from that date.

THE COMPANIES ACT, 1948.

We are fortunate inasmuch as the Act of 1948 consolidates the law relating to companies, comprising as it does the Act of 1929 as amended by the Act of 1947. It entirely avoids making constant references, which would otherwise be necessary, from one to the other of the 1929 and 1947 measures, which one noble and learned Lord likened, in the course of debate, to being "rather like following a tennis ball on the centre-court at Wimbledon."

The merit of consolidation is self-evident when it is realised that the Act applies at present to 250,000 companies with a total paid-up capital of £6,000,000,000.

Perhaps the most striking features of the Act are those provisions which elevate the profit and loss account to the importance of the balance sheet and make it as informative, and the requirements which aim at giving shareholders of holding companies an adequate picture of the group as a whole by the publication of group accounts. Although companies were previously required to prepare and annex to the balance sheet a profit and loss account, the requirements of the 1929 Act as to what the account should contain were negligible. With few exceptions, profit and loss accounts were in the past prepared in most meagre form.

The salient requirement of the Act, *which overrides all the other accounting provisions*, is contained in section 149. This requires that the balance sheet shall give a *true and fair view* of the state of affairs and the profit and loss account shall give a *true and fair view* of the profit or loss of the company. This is intended to ensure that, in preparing the accounts of a

company, not merely the letter, but the *spirit* of the Act must be observed.

It is a misapprehension to imagine that the 1948 Act is designed to protect shareholders from their own apathy, but it does give them a chance to improve their knowledge of their company's affairs.

All the relevant provisions of the new Act are considered in this book in discussing the principles and policies which go to make up the balance sheet, profit and loss account, etc. These include the requirements relating to the contents of balance sheets and profit and loss accounts, the new recommendations in regard to group accounts including consolidated balance sheets and consolidated profit and loss accounts, the introduction of "*exempt*" private companies and the additional powers and responsibilities of auditors. The reader, after studying these pages, will appreciate the extent to which a fuller disclosure of the finances of companies is now required and it will be seen also that a wider distribution than hitherto of the published accounts of companies is obligatory, more particularly in the case of private companies.

It is characteristic of company legislation in this country that the law should bring the general standard of conduct of companies into line with the practices already adopted by progressive companies of the highest repute. Already some companies have gone beyond the requirements of the 1948 Act in the disclosure of their affairs. The practices of some boards of directors to relate in their reports dividends proposed to the *real* capital *employed* (as distinct from capital subscribed) and other companies to disclose the figure of turnover and how this has been absorbed by cost of supplies, wages, depreciation, taxation, interest, dividends, transfers to reserves, etc., in order to show how the industrial cake has been divided, are referred to at some length in Chapter XIV—a chapter devoted to director-shareholder-employee contacts.

MERITS OF THE NEW ACT.

Now that we have had several years' experience of the 1948 Act it is interesting to pause and survey the general impressions of its operation so far as the accounts of companies are concerned.

As a result of the painstaking work of the Cohen Committee, and in contrast to some important legislation of a doctrinaire character which finds its way on to the statute book nowadays, the Act* was certainly not ill-conceived. It was the consummation of a most careful and systematic sifting of expert opinions, resulting from experience since 1929, when the law was last altered.

It should occasion no surprise, therefore, that the Act has, in the main, proved a success in operation. A heavy burden has been placed upon the shoulders of accountants, but there is little doubt that the profession has acquitted itself well and has enhanced its reputation.

A new standard of accounting has been set up, which is not necessarily confined to companies governed by the Act. On this fresh elevation future accounting progress will develop and legislation relating to concerns other than companies (e.g. Friendly Societies, Building Societies, etc.) may be fashioned on similar lines in the future.

Our general accounting vocabulary has been widened, made more precise and generally improved, and as text-books are brought up to date, students will benefit from the more generally accepted meanings of basic terms and a clearer conception of the effects of many fundamental book-keeping entries.

One feature of the Act is its flexibility so far as the accounting provisions are concerned. Companies are allowed a fairly wide latitude in the construction of accounts within the statutory framework. Too much standardisation would be undesirable. We have still a long way to go in the improvement of published accounts, and progress in this direction is facilitated if freedom is allowed to progressive accountants to apply their ideas in the accounts for which they are responsible.

The Board of Trade is given wide powers to alter or add to the requirements (sections 148, 149, 152, 454 and the Eighth Schedule). It is evidence of the intention of the Board to exercise these powers that two advisory committees have already been formed and are operating—a general consultative committee and an accountancy advisory committee.

* References on this and succeeding pages to "*the Act*" refer to the Companies Act, 1948.

SOME CRITICISMS.

From all this it must not be inferred that there have been no criticisms from informed sources. Some have expressed great concern as to whether the Act does not go too far for exempt private companies which, although exempt from filing their accounts, enjoy no exemptions from the requirements as to disclosure in profit and loss accounts and balance sheets. It seems unnecessary to "Cohenise" the accounts of the village dairyman who has converted his business into a private limited company, while to require the two directors and only shareholders of a company to disclose (among other matters) their shareholding in the company in order that the information may be brought up at a meeting of "shareholders" appears to be ludicrous! In the author's opinion, and that of many accountants and secretaries, some of the accounting provisions could, with advantage, have contained an exclusion for the "exempt" private company.

The criticisms that have been made against auditors' reports on the grounds of their excessive length in order to comply with the Ninth Schedule are referred to in Chapter XII.

Apprehension has been expressed in many quarters as to whether, even for public companies, the new form of accounts is so elaborate as to defeat its main object. If shareholders, employees and others do not understand the many refinements introduced for their benefit, so as to make published accounts more informative and profit ascertainment more consistent, the Act fails in its primary purpose.

Sir Frederick Alban, then President of the Society of Incorporated Accountants and Auditors, voiced this apprehension at the 1949 annual meeting of the Society and several eminent accountants have since echoed the same sentiments. He agreed that the Act has put at the disposal of those interested, including the general public, much more information to enable them, or their financial advisers, to assess the financial position and trading prospects of the undertakings. Despite this, he said "accountants, stepping back to admire the products of their skill, may well think, on reflection, that most of the people for whom, in accordance with the desire of Parliament, the elaborate accounting service is being rendered, do not understand what they are getting."

Accounting technique is one of continuous evolution and progress and many companies have already taken steps to

overcome this problem, either by designing their accounts in more concise form so that the main structure stands out prominently (detail being set in smaller type under the appropriate main headings or else relegated to schedules and notes attached to the accounts), or by supplementing the accounts with simplified statements. This important and modern development is dealt with in a new chapter (XIII) in this edition. The serious effects of inflation and its impacts upon the accounts of companies are discussed in Chapter XV.

Before examining in detail the construction and the contents, item by item, of balance sheets and profit and loss accounts and the statements which are annexed thereto, we will consider in the next chapter (more particularly for the benefit of those readers whose experience may not be so wide as that of others) some elementary fundamentals of balance sheets.

Readers requiring a quick revision of the basic principles of book-keeping are recommended to read through the author's short introductory book, *Book-keeping Rapid Course* (Barkeley Book Co., Ltd., Stanmore, Middlesex).

CHAPTER II

SOME ELEMENTARY BALANCE SHEET FUNDAMENTALS

THE NATURE AND FUNCTIONS OF BALANCE SHEETS.

It is customary for those responsible for the financial dealings of an undertaking to prepare a balance sheet at fixed intervals for submission to the proprietors. This is the most convenient form of rendering an account of their stewardship.

Since the earliest days joint stock companies have been no exception to this practice. Table "A" of the Companies Act, 1862, prescribed a form of balance sheet, the assets being shown on the right-hand side and the capital, loans and other liabilities on the left. Although it was not compulsory for a company to adopt this arrangement, the tendency then prevailing of showing debit balances on the right-hand side, and vice versa, received some official impetus thereby and, until the introduction in recent years by some companies of the vertical or "one-sided" balance sheet (described later in this chapter), was the almost invariable practice in this country, but not abroad (one of the few exceptions—Gestetner, Ltd.—is reproduced in Appendix B).

Although most reputable companies prepared a proper balance sheet and presented it annually to shareholders, this was not obligatory until the Companies Act, 1929, came into operation on 1st November, 1929. For the first time in the history of company legislature in England, the Act of 1929 stipulated the intervals at which the balance sheet must be published, and the information it must contain. These provisions have been extended by the 1948 Act and are reproduced and discussed in this book. The Act contains much important new legislation on the subject of balance sheets, in addition to that relating to profit and loss accounts and the group accounts of holding companies, upon which the law was previously almost silent.

At this stage attention will be confined to the general nature and functions of limited company balance sheets, typical examples of which will be found in Appendix B at the end

of the book. Profit and loss accounts and group accounts are dealt with in detail in later chapters.

The assets (i.e. possessions), of the company are displayed on the right-hand side, these being classified under suitable headings, such as Goodwill, Properties, Plant and Machinery, Transport Equipment, Loose Tools, Investments, Stock-in-Trade, Debtors, Cash, etc. It is usual to show these assets in order of permanence, i.e. commencing with the asset which would prove the last to be converted into cash on an enforced sale of the business, and concluding with the cash balance itself. Some companies, however, adopt the reverse procedure, commencing with cash, and ranging the remaining assets in order of liquidity.

In the absence of any "dead wood" in the form of "assets" which are worthless or shown at inflated valuations, the total of the assets side represents the aggregate value of the company's possessions, not, as will be explained later, on the basis of current intrinsic values, but as the approximate worth to the company *as a going concern*.

The company is accountable to various parties for this total value. If there are any secured creditors, specific assets will be charged as security, or alternatively, a floating charge on the assets as a whole may exist. Unsecured creditors possess the next claim in satisfaction of their debts. The residue belongs to the shareholders, and on liquidation, must first be applied to the return of capital; any remaining balance is then divided as profit according to the rights attaching to each class of shares.

The claims of these parties to the assets are set out under appropriate headings on the left-hand or "Liabilities" side. The first item is a memorandum note giving details of the authorised capital, i.e. the amount of capital which the company has power to issue. This power of issue arises from the Memorandum of Association, and the total amount has been subject to an *ad valorem* duty (at present 10s. per cent.). The issued capital is shown in detail immediately below the authorised capital, the amount paid up being extended into the effective money column (see illustration on page 113).

Following the issued capital may appear the undermentioned items:—

- (1) Capital reserves.
- (2) Revenue reserves.

- (3) Undistributed profit carried forward, or, alternatively, *by way of deduction*, any accumulated loss carried forward.
- (4) Debentures and permanent loans.
- (5) Temporary loans.
- (6) Trade creditors, bills payable, and sundry liabilities.
- (7) Provisions.

Capital reserves may consist of premiums on shares and debentures (the former must now be shown separately), capitalised accretions in the value of fixed assets, surpluses on acquisition of subsidiary companies, excess profits tax, post-war refunds, etc. The aggregate of Nos. (2) and (3) constitute the company's revenue surplus, i.e. profits earned and available for dividends or set aside for the several purposes described on later pages. The figure of undistributed profit carried forward is frequently referred to colloquially as the "carry-forward." (A sub-total of the issued capital, together with items (1), (2) and (3) is recommended, as representing the shareholders' interest in the company, as distinct from liabilities to outside parties, which are contained in items (4) to (6) inclusive.) No. (7) relates to provisions for deferred repairs, claims outstanding, etc.

Most of us have been brought up to head the respective sides of the balance sheet with such designations as "Liabilities" and "Assets," but this practice (which is still advocated in many text-books) has now fallen into disuse. In one of the *Recommendations on Accounting Principles* issued by the Institute of Chartered Accountants (1944) the practice is described as "*inappropriate and unnecessary*." During the last year or two, however, the headings "Capital Employed" and "Employment of Capital" have sprung into fairly general use as a means of explaining the nature of the items grouped on the respective sides. This modern nomenclature is both appropriate and helpful in understanding and appreciating the characteristics of a balance sheet.

Most companies continue to employ the conventional two-sided balance sheet as will be observed from the accounts of prominent companies reproduced in Appendix B. It will be seen also that, for the most part, the orthodox practice of showing current liabilities and provisions on the left-hand

side is retained, but there is a growing tendency for these to be grouped on the right-hand side and shown as a deduction from the group total of *current* assets, the balance being appropriately described as "Net Current Assets." An example of this lay-out will be seen in the balance sheets of Fisons, Ltd., on pages 395 and 396. (These balance sheets incidentally have what is normally the right-hand side of the balance sheet set out immediately below the share capital and reserves.)

THE VERTICAL OR "ONE-SIDED" BALANCE SHEET.

Nowadays some companies favour the vertical or "one-sided" form of balance sheet. The following skeleton lay-out shows the general arrangement, which can be varied as necessary according to circumstances and personal inclinations:—

	£	£
Fixed Assets		60,000
Add Net Current Assets (or Working Capital)		
Current Assets	50,000	
Less Liabilities and Provisions	20,000	
		<u>30,000</u>
Total Assets		90,000
Deduct Long-term Liabilities (Debentures, etc.)		<u>25,000</u>
Net Assets		65,000
Deduct Preference Capital		<u>20,000</u>
Ordinary Shareholders' Interest (i.e. the "Equity")—		
Ordinary Capital	15,000	
Share Premium	8,000	
Other Capital Reserves	<u>4,000</u>	
	12,000	
Revenue Reserves (including Profit not yet appropriated)	<u>18,000</u>	
		<u>£45,000</u>

It is claimed by some accountants that this form is normally more comprehensible to the uninitiated, even though it be less orthodox. "Add" and "deduct" are often more understandable terms than "Dr." and "Cr."

An example of the vertical lay-out as applied to the profit and loss account will be seen in the Dunlop accounts on pages

397, 398 and 399. The headings "Statement of Profit" and "Disposal of Profit" are most effective.

WHEN ISSUED AND TO WHOM.

Directors must lay a balance sheet, profit and loss account and group accounts (where applicable), before the company in annual general meeting not later than 18 months after its incorporation, and afterwards, once at least in every calendar year, under penalty of six months' imprisonment, or a fine of £200 (sections 148 and 150). *Every* company must also send a copy of its balance sheet, including the documents required by law to be annexed thereto (which will be referred to in later chapters) and auditors' report to every shareholder and debenture-holder not less than twenty-one days before the meeting at which the accounts are to be presented (section 158).

Members of a private company* were, prior to the Act, only entitled to a copy of the balance sheet and auditors' report on demand and at a charge not exceeding sixpence for every hundred words.

Debenture-holders were not previously entitled to balance sheets except on demand, and even then only in the case of public companies.

As already stated, *all* shareholders and *all* debenture-holders must now be supplied with a balance sheet and the documents required to be annexed thereto (subject to the relatively unimportant exceptions specified in section 158).

Except in the case of "exempt" private companies (section 129), every balance sheet (and the documents required to be annexed thereto) must be filed with the Registrar of Companies (section 127).

SOME COMMON MISCONCEPTIONS.

It may not be out of place in a work of this character briefly to reflect on the theoretical principles of balance sheet construction, and so dispense at an early stage with a number of misconceptions on the matter which are frequently present in the mind of the layman. These academic principles are applicable alike to the balance sheets of companies and other concerns.

* The general characteristics and privileges of private companies and the provisions of the Act relating to what are now known as "exempt" private companies are set out in Chapter XII.

Firstly, a balance sheet is dated, e.g. "Balance Sheet, 31st December, 1951." The date is of vital importance, since the statement purports to reveal the financial position on that date. If the statement had been prepared as at 1st January, 1952, the difference of one day would give rise to material variations in the balances. The transformation of assets and liabilities is a continuous process which goes on during every hour the business is open. Every payment of cash alters the cash balance and reduces creditors or adds to stocks or another asset; every receipt of cash reduces stock or debtors or changes some other balance, and so on.

An appropriate analogy is a snapshot of a train travelling at 60 miles an hour. The camera records the train at a certain place in relation to the surrounding landmarks, as if it were stationary in that particular position, instead of flashing by at a considerable speed.

The balance sheet is a snapshot of the financial position of a business at a given moment of time, i.e. the moment of closing business on the given date, and as in the snapshot, the subject appears stationary.

The same impression of a balance sheet can be obtained by imagining a film, which consists of countless individual pictures flashed on the screen in rapid sequence. The "still" outside the cinema is just one of those pictures as if the projector had been stopped at a convenient moment in order to depict the picture at that particular instant.

Secondly, in addition to its better known function of furnishing information as to the financial position of a concern, a balance sheet can be likened to a bridge from one financial period to the next, as the only means of carrying over a balance to the succeeding period is through the medium of the balance sheet.

This will be appreciated if it is remembered that when the books of account are closed and the revenue balances transferred to the trading and profit and loss account, those which remain to be carried forward to the next period constitute the balance sheet figures. Most of these comprise assets and liabilities in the generally accepted sense, but included also will normally be a number of outstanding items to be carried over. For example, payments made in one year in respect of expenditure applicable to the next will justifiably be excluded from the revenue accounts and charged to the accounts of the following

year. Such items of outstandings automatically appear in the form of debit balances on the assets side of the balance sheet. Items of deferred expenditure such as preliminary expenses, development expenses, etc., are treated in the same manner.

Similarly, unpaid liabilities, e.g. wages, rent, etc., may be provided for at the end of the financial year, or cash may be received on deposit for work to be done, or goods to be supplied, necessitating the raising of credit outstandings, which fall on the liabilities side of the balance sheet.

In all these cases the balance sheet is the connecting link between one financial period and the next, and it accordingly contains items which may not, in every instance, appear to qualify for inclusion among the assets and liabilities.

BALANCE SHEET LIMITATIONS.

An appreciation of the limitations of a balance sheet materially assists in the proper understanding of its functions and usefulness. Its static character has been referred to: it shows the financial position of an undertaking *as a going concern* at a given moment of time, in reality, the moment of closing down business on the last day of the year. It reflects the results of the transactions which have taken place during the period, but it does not purport to show the nature or extent of them. (Some American companies use the designation "Statement of Financial Position" instead of "Balance Sheet.")

By comparison with the immediately preceding balance sheet, the extent of the changes which have occurred in the interim can readily be perceived, but the causes of the variations are rarely apparent.

In the same manner as the result of a sporting event gives little or no indication of the endeavour or ease with which it has been accomplished, so a balance sheet must not be expected to reveal any detail as to the transactions which have ensued during the financial period.

The incidents which lead up to the result of a sporting event are subservient to the result itself, and are therefore afforded less prominence in the pages of our newspaper. Likewise, the volume of operations carried out by a business is of less concern to the proprietors than the final net profit derived from them.

The balance sheet, therefore, when it is compared with the immediately preceding balance sheet, depicts the changed situation as a result of such operations. If it is realised that with this function its utility as an adjunct to commercial life begins and ends, much disappointment and misgiving will be obviated.

Information as to how profit has been derived, or loss sustained, is contained in the profit and loss account, with which we shall be concerned later in this book; only the resultant profit or loss, as ascertained therein, being brought into the balance sheet.

Another characteristic peculiar to balance sheets is that they do not profess to show all the assets and liabilities at "break-up" valuations. In the main, the items are included at their worth to the undertaking as a continuing concern at a specific date. This statement, however, is subject to some important qualifications and legal requirements which will be fully treated in succeeding chapters.

The Act requires that *corresponding amounts* at the date at which the immediately preceding balance sheet was made up shall be shown. (Eighth Schedule, para. 11.)

Some companies show the comparative figures in a column adjacent to the current figures instead of adopting the more usual practice of setting them out before the narrative. In the author's view this form is more convenient when comparing the results of the two years as the eye does not have to travel over the narrative at each step. It is an additional advantage to show the figures for the corresponding period in a contrasting colour or type to those of the current year.

It has been said, with some truth, that changes between one balance sheet and the next are of more interest than the figures in any single balance sheet. A few companies go far beyond the requirements of the Act by giving in a schedule annexed to the accounts summarised figures of assets and liabilities for several past years, a practice which is more common in America. (The accounts of Dunlop Rubber Co., Ltd. are accompanied by a statement—reproduced on page 407—which shows comparative results for the past nine years.)

OVERRIDING REQUIREMENT OF THE ACT

In the mode of presenting accounts to shareholders in this country there exists nowadays a happy compromise between

flexibility and statutory standardisation. Within the framework of the many accounting provisions of the Act, a considerable measure of latitude is allowed in the design and arrangement of accounts.

The primary obligation in regard to the balance sheet imposed by the new Act is that the statement must show *a true and fair view of the state of affairs of the company* (section 149). (This is a similar provision to that relating to the profit and loss account, mentioned in Chapter XI.) While the many provisions of the Act (contained for the most part in the Eighth Schedule) are designed to ensure that the balance sheet does give a true and fair view of the financial position, the overriding requirement contained in section 149 imposes an obligation upon companies to observe the spirit and not merely the letter of the Act. That is to say, if certain information is essential to display a "true and fair view" in the balance sheet that information must be included, even though not specifically required by the Act.

MODERN PRACTICES IN PRESENTATION OF FIGURES.

Although not of paramount importance, it may be useful to mention the modern practice of omitting shillings and pence in the published accounts of companies. Nowadays, when amounts in the accounts of companies are often very considerable, the practice of "rounding-off" figures to the nearest £ has much to commend it. To include up to four insignificant digits after each amount of pounds is to place an unnecessary burden on the vision. Except in the case of small companies, shillings and pence have no significance, and the old conception that they create an impression of scrupulous accuracy is not now valid. (The writer was once criticised for omitting fractions of a penny from a balance sheet!) When amounts are very large, as in national estimates and financial statements, the figures are often expressed to the nearest million pounds.

In making reference to the modern practice of omitting shillings and pence in published accounts, it may be of interest to relate a criticism recently voiced in the United States which attributes in part the layman's misunderstanding of accounts to giving approximate figures the appearance of meticulous accuracy. For example, an annual charge for depreciation, based on estimates of effective life and residual value, might be more realistically shown at £900 than at £897 16s. 11d.

It is not uncommon in America to omit cents from published accounts, in fact at least one concern eliminates cents as soon as they appear, the resultant debits being charged to commercial discount and the credits to a provision for bad debts.

Some holding companies have adopted the practice of showing group figures in a column adjacent to those relating to the holding company, instead of embodying each in a separate statement. This arrangement is neat and convenient and provides an easy connection between the affairs of the parent company and that of the group. It perhaps suffers the disadvantage of including too many figures on one page as four amounts will be appended to most narrations, two for the current year and two sets of corresponding figures. Despite this criticism, the lay-out is commendable, and where the group figures are included in print of a different colour, the possibility of confusion is reduced.

It has become the practice recently to number consecutively the items in the balance sheet so that convenient references may be made in the notes or in documents annexed to the statement. (The Act allows some information to be given *either* in the accounts or *by way of note* (Eighth Schedule, paras. 11 and 14).)

Modern methods of setting out individual items and groups of items in the balance sheet are mentioned in subsequent chapters.

CHAPTER III

FIXED ASSETS

DISTINCTION BETWEEN FIXED AND CURRENT ASSETS.

Fixed assets are those held by a company for retention and use in the operations of the business. Current assets, by distinction, comprise debts, stocks, investments, etc., acquired for the purpose of conversion into cash in the normal course of business. It has been said that a fixed asset is one that is employed over and over again in the earning of income, but a current asset is used once only.

This division of tangible assets between fixed and current is observed in the Act, but no statutory definitions are given and it is left for commercial usage to maintain the line of demarcation. The Cohen Committee defined fixed assets as "*assets not held for sale or for conversion into cash*" and current assets as "*cash and assets held for conversion into cash.*"

The motive for which an asset is purchased, and its nature in relation to the type of business conducted, are the criterions in classifying it under the respective headings of fixed and current. The internal characteristics of the asset, considered apart from its surroundings, count for little.

Thus, a motor car, to the manufacturer who builds it for sale, is a current asset, but when the car is acquired by a purchaser for use in his business, it becomes a fixed asset. If, in course of time, the purchaser disposes of it to a second-hand dealer, its classification reverts to that of a current asset in the dealer's books. The same asset may accordingly alternate between fixed and current during the course of its effective life. The determining factor is whether, on acquisition, the asset was bought (a) for retention, or (b) for re-sale, either in the same state or after the process of manufacture.

Fixed assets comprise land, buildings, plant, machinery, transport equipment, ships, loose tools, etc. Current assets will be discussed at length in the succeeding chapter. No real difficulty is experienced in practice in distinguishing between the two.

GENERAL CLASSIFICATION.

It is now a common practice to classify assets in the balance sheet under the heads of:—

- (1) Fixed Assets.
- (2) Current Assets.
- (3) Other Assets.

The Act requires that "Fixed Assets shall be distinguished from Current Assets" (Eighth Schedule, para. 4). The most convenient way of observing this requirement is to show each asset under its appropriate heading, fixed or current, and this is the invariable practice.

A rather surprising deficiency in the Act is the apparent assumption that all assets fall into either one or the other classification. In practice such assets as preliminary expenses, share and debenture discounts, expenses and commission on issues of shares and debentures (all items of "dead wood" in a balance sheet) cannot be regarded as either fixed or current assets. Similarly, shares in and amounts owing by subsidiary companies are not always capable of accurate description by either of the two available designations. A third classification has therefore been introduced above, i.e., "other assets."*

There is, of course, a very real objection which can be advanced against using the word "asset" to describe items of intangible expenditure not written off, and many accountants will prefer to employ headings such as "Other Debit Balances" or "Intangible Expenditure" instead of "Other Assets." Another alternative is to show each asset which cannot appropriately be classed as "Fixed" or "Current" as a separate heading, suitably described.

REQUIREMENTS OF THE ACT,

The main requirement of the Eighth Schedule in regard to fixed assets is that the method or methods used to arrive at the amount in each case shall be shown (para. 4). Normally they are required to appear in the balance sheet either at cost or at a valuation, and depreciation provided to date included

* The Board of Trade has stated, in answer to an enquiry, that an asset need not be described as "Fixed" or "Current" if to do so would not be a true and fair description, *provided the nature of the asset is clearly stated.*

by way of deduction, the difference appearing as the net book value at the date of the balance sheet (para. 5).

If, therefore, a company acquires freehold buildings at a cost of £10,000, and depreciates the property at the rate of 1 per cent. per annum of the original cost, at the end of ten years £1,000, i.e. 10 per cent., will be written off. The most adequate interpretation of the foregoing provision is to show the buildings in the balance sheet in the following manner:—

ASSETS SIDE.

	£	£
Freehold Buildings, at cost	10,000	
Less Depreciation to 31st December, 19—	1,000	
		9,000

This method of presentation met with official approval twice in 1945 (i.e. three years before the Act came into force): firstly in the recommendations on depreciation issued by the Institute and shortly afterwards in the Cohen Report.

A common method of showing a fixed asset in the balance sheet until 1948 was to include it at its written down value as at the beginning of the year (i.e. the figure at which it appeared in the last balance sheet), deducting only the depreciation charged in the current year, as illustrated:—

ASSETS SIDE.

	£	£
Freehold Buildings (at Cost, <i>less</i> Depreciation), as at 1st January, 19—	9,100	
Less Depreciation	100	
		9,000

This clearly showed the amount which has been written off in the year under notice, although no indication of the original cost of the asset, or the total amount of depreciation to date, was given. The Act rendered this practice obsolete for companies.

The general requirement is subject to a number of exceptions, both as to the original book figure of an asset and also as to the accumulated provision for depreciation.

Before examining these exceptions, it will be noticed that the "valuation" basis is an alternative to showing an asset at cost but, as is logic, this applies only when it stands in the books at a valuation as distinct from being recorded originally at cost, e.g., when a group of assets has been acquired in the past at a global price, which has been apportioned over

the assets purchased, or when a business has been taken over as a going concern and a similar apportionment has been necessary. Where it had been the practice to credit depreciation to the asset account prior to 1948 and the original cost could not be obtained "without unreasonable expense or delay," the net amount at which the asset stood in the books on the coming into force of the Act could be treated as the valuation at that date. Subsequent balance sheets show this figure less the amounts of any sales since the valuation was made on this basis. A question of interpretation has arisen on the words "*less the amount of the sales*" in para. 5 of the Eighth Schedule. Does this mean the gross proceeds derived from the sale of a portion of the asset or does it mean the book value of the portion sold? Thus, if a one-tenth part of an asset notionally valued at £5,000 on 1st July, 1948, is sold in 1951 for £750, should the asset be shown in the balance sheet at December, 1951, at £4,250 or at £4,500? According to a recommendation of the Institute recently, the latter is the better interpretation and this, of course, accords more with generally accepted accountancy principles.

It may perhaps be useful to reiterate that whether an asset be shown at cost or at a valuation (either computed in the past or when the Act came into force, in 1948), depreciation provided to date must normally be separately shown as a deduction. As already mentioned, these general requirements are subject to exceptions, which will now be considered.

Dispensation is afforded when the figures relating to assets acquired *after* the Act came into force cannot be obtained "without unreasonable expense or delay." No guidance is given as to what constitutes "unreasonable expense or delay" but, in the writer's view, auditors will be lacking in their duty if they do not draw attention in their report to any case where they are not in agreement that the expense involved or delay caused is "unreasonable" (e.g., where an expert valuer could be asked to value each type of asset acquired as part of a bulk purchase).

Where provision for replacement is provided wholly or partly by setting aside to a renewal provision and charging replacements against that provision, the asset may appear in the balance sheet at cost or at a valuation, without deduction. (In such cases, which are not uncommon, the unexpended portion of the renewal provision must be shown among the

provisions in the balance sheet (Eighth Schedule, para. 5). Similarly, when it is the practice to charge replacements direct to revenue, the asset will appear without deduction for depreciation and any balance on a renewal account (created to equalise replacements) must appear in the balance sheet. In both these cases the means by which replacement is provided for must be shown (para. 5). If no depreciation is provided in respect of an asset (e.g., in the case of freehold land) that fact must be stated (para. 14).

Certain classes of assets specified in para. 5 are excluded from the foregoing requirements for fixed assets, i.e.:—

- (1) *Investments* of which the market value (or, if there is no market value, the value as estimated by the directors) is shown either as the amount or by way of note.
- (2) *Goodwill, Patents or Trade Marks.*

DISPLAY OF FIXED ASSETS.

In giving effect to the requirements of the Act in regard to fixed assets, there is a tendency for some companies, owing to an unwieldy arrangement of items, to spread the balance sheet over an unduly large area of paper and sometimes to extend the items over two pages, necessitating much backward and forward reference. This makes the task of surveying the general financial position of the company more difficult. By contrast, many companies have adopted expedients which, whilst not omitting any essential information, have reduced the area over which the balance sheet is spread and, as a result, rendered it much more convenient to read.

One commendable practice is to set out the requisite information relating to each group of fixed assets horizontally instead of vertically, that is to say, on one line; columns being employed to record the cost price and/or valuation of the asset and the depreciation provided to date, the balance being extended into the outside column. Those companies which give particulars which go beyond the minimum requirements of the Act are able to do so by merely increasing the number of columns and still only employing one horizontal line for each asset group. For example, the following figures may conveniently be shown on each line:—

Cost to date of last balance sheet, and/or

Valuation at date of last balance sheet.

Additions during year.

Disposal during year.

Depreciation provided to date of last balance sheet.

Depreciation provided for year.

If this information is displayed in the form illustrated below an elongation of the fixed assets is avoided, and the general arrangement of the balance sheet appreciably enhanced:—

At Valuation	At Cost	Additions during year to date	Disposals during year to date	Provision for Depreciation		Balance 30th Sept. 1951	Previous year
At 30th Sept., 1950	At 30th Sept., 1950			To 30th Sept., 1950	For year to date		
£	£	£	£	£	£	£	£

Examples of this arrangement will be seen in the balance sheets of Morris Motors Ltd. on pages 351 and 353.

Another alternative, which is adopted by some companies, is to show only the final figure for each group of fixed assets, the requisite detailed information being displayed in a schedule annexed to the balance sheet. The balance sheet of Fisons, Ltd., on page 395 is an example of this. The note annexed to the balance sheet is reproduced below:—

FIXED ASSETS—FISONS LIMITED. 30TH JUNE, 1949.

30TH JUNE, 1950.

	Net Book Amount at 30th June, 1948 (Less Disposals) or at Cost	Depreciation since 30th June, 1948	Net Amount		Net Book Amount at 30th June, 1948 (Less Disposals) or at cost	Depreciation since 30th June 1948	Net Amount
Freehold Land and Buildings	£ 490,930	£ 11,049	£ 479,881		£ 458,887	£ 20,146	£ 438,741
Leasehold Land and Buildings	546,246	16,694	529,552		1,417,443	55,236	1,362,207
Office and Other Properties	185,340	7,723	177,617		192,162	11,351	180,811
Plant, Machinery and Motor Vehicles ..	935,938	98,137	837,801		3,155,426	240,845	2,914,581
Additions under Construction	2,462,270		2,462,270		1,218,771	—	1,218,771
TOTAL ..	£4,620,724	£133,603	£4,487,121		£5,442,689	£327,578	£5,115,111

SPECIAL TREATMENTS NECESSITATED BY THE ACT.

Where it had been the practice prior to 1948 to credit all depreciation to one account and show one global figure among the liabilities in the balance sheet, it was necessary with the first account prepared after July, 1948, to apportion the balance

of the depreciation account so that the amount appropriate to each asset appeared as a deduction from that asset. The only alternative available appears to have been to regard the aggregate accumulated depreciation as a provision for renewals against which replacements are charged.

Part IV of the Eighth Schedule imposes an obligation upon directors to restrict provisions for depreciation to amounts which in their opinion are not "*in excess of that which . . . is reasonably necessary for the purpose.*" Many companies, since the Act came into force, have been confronted with the problem of dealing with excess amounts provided in the past. The Institute has offered some guidance on this problem, and has drawn attention to the distinction between depreciation *written off* and depreciation *retained* in the wording of sub-para. (2) of para. 27. "Writing off" depreciation implies, of course, crediting the amount provided to the asset account (a hitherto common procedure which, as stated earlier, is not now valid, as the original cost or valuation of a fixed asset is required to be shown in the balance sheet) and "retaining" depreciation means crediting it to a separate depreciation account.

If we follow the recommendation of the Institute, we shall regard *as a reserve* that portion of depreciation *retained* which, at the coming into force of the Act, is in excess of the amount which the directors consider to be an adequate figure and transfer the sum involved to a reserve account. Depreciation can then be provided each year on a "not more than adequate basis" and credited to the depreciation account.

When, however, excessive depreciation has been *written-off* in the account of an asset, the Institute considers there is no obligation imposed by the Act to write any excess depreciation back again into the asset account, but future depreciation provided must be treated as a *reserve* (i.e. not as a provision) until such time as the total amount credited to the asset account is not, in the opinion of the directors, excessive.

Some may consider that, in such circumstances, no depreciation need be reserved in the interim, but this view tends to overlook that the profit and loss account is required to "give a true and fair view of the profit and loss" which may be impossible unless revenue is debited each year with a proper charge in respect of the assets employed.

DEPRECIATION.

The process of depreciation seeks to spread the original cost of a fixed asset over its useful life on an equitable basis, in such a manner that on expiry of its life, the asset account will be either extinguished entirely, or reduced to an amount which approximates to the scrap or break-up value. The original cost is, therefore, justly spread over the profit and loss accounts of the years which have the use and benefit of the asset. This is the orthodox and generally accepted basis of depreciation which, despite the recent criticisms of prominent industrialists and economists (which are discussed at length later in this book), has not been departed from to any appreciable extent in this country.

The annual charges to revenue do not necessarily imply any close relation to alterations in value, but seek only to distribute the original capital outlay over the life of the asset. The balance sheet accordingly, in normal cases, records fixed assets from the aspect of what has been done in the spending and spreading of capital outlay, and not from the viewpoint of current realisable values which are nowadays considerably in excess of the unexpired proportion of the first cost.

Much confusion of thought exists in this regard, and some criticism arises through failure to recognise that fixed assets are held for use in a continuing business, and not for disposal at a profit.

Where any amount is written off or provided for depreciation in excess of that which, in the opinion of the directors, is reasonably necessary for the purpose, the *excess* must, in accordance with the Act (Eighth Schedule, para. 27), be treated as a *reserve* and not as a *provision for depreciation*. (The distinction between *reserves* and *provisions* is explained in Chapter IX and the effect of the new statutory requirements in their application to secret reserves is also discussed in that chapter.)

Depreciation denotes reduction, and in accountancy terminology the word is employed to indicate the process of writing down asset values. The Institute recently defined depreciation as representing "that part of the cost of a fixed asset to its owner which is not recoverable when the asset is finally put out of use by him." Provision against this loss of capital is an integral cost of conducting the business and is not dependent

upon the amount of profit earned. Almost all material assets depreciate, either by reason of use, i.e. wear and tear (e.g. machines), or by effluxion of time (e.g. a lease). Apart from these two inherent causes, depreciation may arise from external circumstances, as in the case of investments being affected by monetary and political conditions and machines rendered obsolete by progressive inventions, etc.

Appreciation, which will be treated later in this chapter, is the opposite movement of values, i.e. in an upward direction, e.g. increase in the worth of land, buildings, and investments, the causes of which are invariably external, and often unexpected.

The obvious necessity for providing for depreciation in normal cases need not be stressed, but the reasons for making this provision might usefully be tabulated as under:—

- (1) The capital outlay involved in the acquisition of an asset needs to be spread over its life, otherwise shareholders' capital is consumed in the process of earning income.
- (2) Each arbitrary division into periods of the company's financial dealings (usually one year) should be charged with "rent" for the use of the assets employed in the conducting of operations. If the profit and loss account escapes a suitable charge in respect of each asset, profit will be over-stated, giving rise to the state of affairs mentioned under (1), to the ultimate detriment of the shareholders.
- (3) In most instances provision for the replacement of the asset at the termination of its useful life is necessary, the accumulated provisions being available (although not necessarily in liquid form) to meet this expense.

This last factor does not apply in every case, since all assets do not call for renewal, but Nos. (1) and (2) are canons of prudence which no responsible business man is likely to ignore. There are, nevertheless, isolated circumstances, where depreciation is regarded as a redundancy, e.g. a mine, quarry, or other wasting asset, which, when completely worked, concludes the operations of the company, and calls for liquidation. Dividends received by the shareholders have accordingly included a partial return of capital, the capital portion being equivalent

in the aggregate to the capital outlay consumed and not made good. The case of *Lee v. Neuchâtel Asphalte Co., Ltd.* (1889), cited on page 202, is an example of this. Such instances are, however, so rare that any consideration of the exceptional principles involved can be neglected at this juncture.

The important considerations which have arisen in recent years owing to the increased costs of replacement are also ignored at this stage. This complex and contentious aspect of making provision for replacement is discussed at some length in Chapter XV.

Having established the vital necessity for making provision for depreciation in normal circumstances, the next step is an examination of the several methods, each effective in its own sphere, of performing this function.

The systems available fall under two general headings; firstly, those which ignore the element of interest, and secondly, methods which take account of this constituent, as recorded below:—

(1) *Ignoring Interest.*

- (a) Straight-line method.
- (b) Diminishing balance system.
- (c) Provision to cover renewals and repairs.
- (d) Direct appraisal.
- (e) Production unit method.

(2) *Including Interest Element.*

- (f) Depreciation fund system.
- (g) External insurance policy.
- (h) Annuity method.

The method adopted for a particular asset should be applied consistently from one period to another and it is recommended that if additional provisions prove to be necessary, they should be stated *separately* in the profit and loss account.

(a) The **STRAIGHT LINE METHOD** involves the writing-off of a fixed percentage of the original cost of an asset in such a manner that each year bears an equal burden of the capital outlay (assuming no changes by way of additions or disposals occur). The first cost is spread *pro rata* over the effective life of the asset, and if original estimates prove to be correct, the asset account will be written down to zero or residual value at the termination of its life. The annual depreciation debited to profit and loss account is credited to a depreciation account in the manner suggested earlier in this chapter.

This method is simple, certain of result, and avoids an undue burden in any particular year. It is particularly appropriate when capital is spread over a considerable number of assets, and for those assets which call for little or no expenditure on upkeep. Leases, buildings, land, furniture and certain types of equipment, not subject to excessive wear, are typical examples of assets which can effectively be depreciated on this basis. The Institute has advocated the wider adoption of this method, which is used almost universally in the U.S.A. and Canada.

It may, however, be unsuitable for assets requiring constant expenditure on upkeep, or when the useful life is incapable of near estimate. The latter disability arises out of the risk of assets becoming completely written off when their service can be prolonged for a few years. Revenue is therefore unjustifiably relieved of any charge in those years at the expense of former periods.

(b) By the DIMINISHING BALANCE SYSTEM a percentage is written off the asset annually, calculated, not on original cost, but on the balance brought down each year. Assuming a machine is purchased at a cost of £1,000, and written down at the rate of 20 per cent., the calculations will be effected in the following manner:—

	£	s.	d.
<i>First Year.</i>			
20% of £1,000	200	0	0
<i>Second Year.</i>			
20% of £800 (i.e. £1,000—£200)	160	0	0
<i>Third Year.</i>			
20% of £640 (i.e. £800—£160)	128	0	0
<i>Fourth Year.</i>			
20% of £512 (i.e. £640—£128)	102	8	0

and so on, the amount of annual depreciation reducing in the form of a curve. This procedure, imposing as it does, a burden on the earlier years, to the corresponding benefit of later periods, is particularly suitable for assets such as machinery and plant, which require an appreciable expenditure on repairs. The costs of upkeep fall more heavily on the later years of the asset's life, revenue being compensated by gradually diminishing charges in respect of depreciation.

Theoretically, as the cost of repairs rises annually the charges for depreciation diminish in inverse proportion, thereby effecting an equal charge year by year for capital outlay and

maintenance. While such hypothetical exactitude is unattainable in practice, the general tendency will undoubtedly be in the direction of approximate equalisation, and the process has much to commend it.

A further advantage of this system is that for all practical purposes the asset never becomes written off; in fact the complete elimination of the asset account from the books is an impossibility in practice. Any prolongation of life therefore, even if accompanied by heavy repair costs, is automatically reflected in the books in such a manner that the scales between capital and revenue tend to remain evenly balanced.

There are, however, one or two disadvantages, not infrequently disregarded in accounting works. The slowness of this method in writing off an asset is often overlooked, with the result that too low a rate is adopted. To illustrate this it may be mentioned that in order to leave a residual scrap value of, say, 10 per cent. of original cost, it is necessary that the depreciation calculations shall run for more than double the time that would have been required by applying the same annual percentage rate on the straight-line basis. Alternatively, a rate more than double the straight-line rate is required on the diminishing balance basis to reduce to that scrap value in the same period.

Moreover, it is sometimes asserted that this method fails to recognise the characteristics of some machine installations, which necessitate a measure of repairs during the first year or two, and then operate trouble-free for an appreciable period, after which repairs increase year by year.

The curve for repairs accordingly falls during the early stages until the machine reaches a point when its efficiency is highest. Repairs then remain almost constant for a time, subsequently proceeding in an upward direction.

(c) To overcome these disadvantages a comprehensive PROVISION TO COVER REPAIRS AND RENEWALS may be adopted, and it is a matter of astonishment that this alternative is not more widely followed, as, with assets requiring more or less constant upkeep, like mechanical appliances, an equal charge against revenue in each year is accomplished. A fixed percentage of the original cost of the asset is charged to the profit and loss account each year and credited to a depreciation and repairs account. All repairs and renewals

(whether partial or complete) are debited to this account instead of to revenue. In order to ensure successful operation of this method, the amount carried to the depreciation and repairs account must be adequate to cover the above charges over the entire life of the asset. The account will, in the absence of abnormal expenditure on repairs and renewals in the early years, maintain a credit balance, which is shown on the balance sheet, either as a deduction from the asset, or, more often, as a contra balance on the liabilities side.

This method achieves with exactitude what the diminishing balance method sets out to accomplish approximately, but against this it is contended that when expenditure on repairs is incapable of estimation at the outset, the method loses its advantage owing to difficulty in determining the rate of annual provision to be employed. If the rate is excessive, a surplus credit balance will remain on the depreciation and repairs account at the finish, and if too low a rate is used, the account will prove inadequate and require feeding from revenue in the later years.

(d) **DIRECT APPRAISAL**, under normal conditions, is employed only when the more scientific methods are unsuitable, and is mainly used for assets such as loose tools, crockery, sports equipment, jigs, patterns, casks, bottles, containers, deck chairs, etc., where loss by pilferage and carelessness may arise in addition to shrinkage in value by wear and tear. Units of live stock are best dealt with on the basis of appraisal in order that the circumstances peculiar to these assets, i.e. condition, weight, temperament, etc., can be taken into account.

Appraisal is inconvenient in operation, calling for a physical stocktaking by counting, weighing or otherwise assessing the current value. Moreover, the valuation requires to be made at the date of the balance sheet which may prove troublesome when a large number of assets need to be dealt with simultaneously. Another disadvantage lies in the varying charges which fall to revenue year by year irrespective of the benefit derived from the assets.

By appraisal the current value is reflected in the balance sheet, but it is emphasised that this is not analogous to saleable value, although in many cases market prices will form the basis of assessment.

Valuation on a market value basis may be necessary when

assets need to be assessed for prospectus certificates, mortgages, and insurances.

(e) The PRODUCTION UNIT METHOD is prompted by the requirements of costing, and is an attempt to spread capital expenditure on the basis of output so that depreciation becomes a charge to revenue variable with turnover. It is applicable to plant and machinery, and the method is frequently expanded to embrace maintenance and running costs, i.e. fuel, machine labour, etc. The average annual output of the machine, or group of machines, is estimated at the outset and a pre-determined rate per hour, per job unit, or per process applied to all jobs executed. In this manner each job bears a debit for the use of the machinery and the corresponding credits go to reduce the value of the asset in the books.

When the machine charge is intended to cover maintenance and running costs, machine overheads are credited to a machine oncost account (a separate oncost account being maintained for each machine or group of machines), and all expenditure in respect of repairs, machine labour, fuel, etc. debited thereto instead of to revenue. The credit balance on each oncost account at any date represents the accumulated provision for renewals and outstanding repairs, if any.

The utility of this method is not confined entirely to machinery, as manufacturing and other facilities, e.g. land acquired to accommodate deposits of slag, refuse, etc. can sometimes effectively be depreciated on the basis of tonnage unloaded. Other examples are that of a warehouse, the original cost of which can be spread over the commodities stored on a unit, or weight plus time basis, and the cost of a motor car which may be written-off on a mileage basis. Similarly, mines, oil wells, quarries and similar assets of a wasting character may appropriately be depreciated in proportion to basic raw material extracted.

The advantages claimed for this method are: (1) the costing of each job, process, unit or contract is facilitated, as the ultimate cost includes a suitable proportion of machine oncost, and (2) a larger proportion of capital outlay is borne by prosperous years which are better able to bear it.

The machine unit method is not a happy choice when an extended period of trade activity or, conversely, of depression, sets in. In the former eventuality the asset becomes written

down too quickly, and in the latter case too slowly, so that in neither instance does the reduction of the asset account to scrap value coincide with the end of the asset's useful life. Against this it may be said that during long periods of working at high pressure, when perhaps day and night shifts are engaged, the machines will deteriorate more quickly than when the factory is working short time. The method, however, has much in its favour within its own particular field.

In the various methods of depreciation discussed up to this stage, two elements have been ignored: the question of interest and the possibilities of obsolescence. The remaining systems to be treated take cognizance of the element of interest, and the obsolescence contingency will be considered later in this chapter.

(f) The DEPRECIATION FUND SYSTEM, in its complete application, pre-supposes the investment of the amounts set aside as provisions for depreciation in securities outside the business. Such a sum is provided out of profits each year as will accumulate, at a given rate of interest, to the amount required to restore the asset at the estimated date of replacement and at the same cost. A corresponding amount of cash is invested annually in securities earning the same rate of interest. The interest received each year is re-invested, and at the end of the term the securities are realised and the cash utilised to replace the assets. This is exemplified in the following:—

£6,000 is paid for a lease for a term of seven years. The depreciation fund is operated on a basis of 4 per cent., an annual provision of £759 13s. 2d. being necessary in order to replace the lease at the end of the period. The entries for the first two years will be as illustrated:—

FIXED ASSETS

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Dr.	LEASE ACCOUNT.	Cr.
Year 1.	£	£
Jan. 1. To Cash	6,000	

Dr.	CASH ACCOUNT.	Cr.
	£ s. d.	£ s. d.
	Year 1.	
	Dec. 31. By Depreciation Fund Investment Account (investment of cash equal to first year's instalment) ..	759 13 2

Year 2.	Year 2.
Dec. 31. To Lease Depreciation Fund Account (interest on first year's investment) ..	Dec. 31. By Depreciation Fund Investment Account (ditto, plus investment of £30 7s. 8d. interest) ..
30 7 8 ¹	790 0 10

LEASE DEPRECIATION FUND ACCOUNT.					
Dr.			Cr.		
Year 1.	£	s. d.	Year 1.	£	s. d.
Dec. 31. To Balance, c/d. . .	759	13 2	Dec. 31. By Profit and Loss Account . . .	759	13 2

Year 2.	Year 2.
Dec. 31. To Balance, c/d. ..	1,549 14 0
	Jan. 1. By Balance, b/d. ..
	Dec. 31. " Cash (interest) ..
	" Profit and Loss Account ..
	759 13 2
	£1,549 14 0

Year 3.
Jan. 1. By Balance, b/d. ..
1,549 14 0

DEPRECIATION FUND INVESTMENT ACCOUNT.			
Dr.		Cr.	
Year 1.	£ s. d.	Year 1.	£ s. d.
Dec. 31. To Cash	759 13 2	Dec. 31. By Balance, c/d. ..	759 13 2

Year 2.	Year 2.
Jan. 1. To Balance, b/d. ..	759 13 2
Dec. 31. " Cash (instalment and interest re-invested) ..	790 0 10
	£1,549 14 0

Year 3.
Jan. 1. To Balance, b/d. ..
1,549 14 0

NOTE—(1) Care must be exercised so that this is not credited to the General Interest account.
 (2) Income Tax on Investment Interest has been ignored.

<i>Dr.</i>	PROFIT AND LOSS ACCOUNT.	<i>Cr.</i>
	£ s. d.	
Year 1. To Lease Depreciation		
Fund	759 13 2	
Year 2. To Lease Depreciation		
Fund	759 13 2	

BALANCE SHEET (*First Year*).

	£ s. d.		£ s. d.
Lease Depreciation		Lease Account ..	6,000 0 0
Fund	759 13 2	Depreciation Fund	
		Investments ..	759 13 2

BALANCE SHEET (*Second Year*).

	£ s. d.		£ s. d.
Lease Depreciation		Lease Account ..	6,000 0 0
Fund	1,549 14 0	Depreciation Fund	
		Investments ..	1,549 14 0

At the end of seven years the above accounts will appear in the balance sheet as under:—

	£ s. d.		£ s. d.
Lease Depreciation		Lease Account ..	6,000 0 0
Fund	6,000 0 0	Depreciation Fund	
		Investments ..	6,000 0 0

The lease account will be then written off to the depreciation fund, and when the investments are realised, £6,000 becomes available (subject to any profit or loss on sale) for renewal of the lease.

Benefit accrues from the adoption of this system in the form of interest received on the depreciation invested, a smaller annual charge against revenue being necessary in consequence, in order to produce the requisite amount in a given period of years. A further advantage lies in the certainty that cash will be available to renew the asset when it falls due for replacement.

This last mentioned factor is not always fully recognised. Adequate provision for depreciation does not, of itself, ensure that *cash* will be available at the date of renewal. Depreciation written off annually constitutes a reduction of profit by a like amount, so that profits which would otherwise

be disbursed as dividends are retained in the business. These funds are not necessarily in the form of cash; they may be represented by debtors, stocks, etc. or by fixed assets, the liquidation of which might occasion embarrassment if necessitated at short notice. By the employment of the depreciation fund system this risk is obviated, and its appeal is therefore strongest when the expediency for providing cash for replacement is greatest. When the asset concerned constitutes an appreciable proportion of the total assets, or when income in a particular business is liable to fluctuations, this system is an admirable choice.

When circumstances dictate that funds can be more profitably employed within the business than in outside investments, the foregoing procedure has no appeal. It is obviously absurd to invest in securities earning, say, 4 per cent. interest when accommodation has to be obtained by bank loans or debentures at a cost of 6 or 7 per cent.

To meet such conditions a more modified application of this method may be employed. The depreciation fund can be built up on similar lines, but the investment of a corresponding amount in outside securities is neglected. The interest which then takes the place of income receivable from investments is credited annually to the depreciation fund account by means of a contra debit to revenue. The depreciation fund accordingly remains invested in the business, the profit and loss account of each year appropriately bearing a debit for interest at a pre-determined rate, calculated on the balance standing to the credit of the fund at the beginning of each year.

(g) An alternative to the depreciation fund system, when outside investment is desired, is the **INSURANCE POLICY METHOD**. A policy is effected to mature at the end of the life of the asset, the annual premiums being credited to cash and debited to a policy account. A similar amount is debited to revenue and credited to an asset redemption account; this entry constitutes the depreciation charge in the year's accounts. The operation is therefore similar to the foregoing system, except that interest receivable does not accrue until maturity of the policy. This may be anticipated in the interim by debiting the policy account and crediting the asset redemption account with interest each year so calculated that, at maturity of the policy, both accounts correspond to the capital sum to be received.

It is sometimes contended that the policy account should appear in the balance sheet at a figure which is not in excess of surrender value, as the possibilities of the asset becoming obsolete may necessitate the discontinuance of the premiums. This presents no difficulty in practice as book entries between the policy account and asset redemption account can be made at any time during the currency of the policy, or at maturity.

A further alternative treatment in the books is illustrated by the following entries, made at the end of each year, and set out below in journal form for clarity:—

		£	s.	d.	£	s.	d.
Lease Insurance Account ..	Dr.	800	0	0			
To Cash					800	0	0
For payment of annual premium to Insurance Company.							
Profit and Loss Account ..	Dr.	800	0	0			
To Lease Insurance Account ..					800	0	0
For charges for Insurance in lieu of Depreciation.							

It will be noticed that the entries in the lease insurance account cancel out each year, revenue receives a charge for depreciation, and an equivalent cash sum is expended annually by way of premium. Throughout the term of the policy the asset remains in the balance sheet at cost, depreciation being entirely omitted. This omission is balanced by the non-inclusion of the policy account on the assets side, an example of "two wrongs making a right" in the balance sheet. This method of presenting the facts in the balance sheet is open to the objection of non-disclosure, and is therefore not recommended.

An insurance policy will prove somewhat more expensive in operation than the depreciation fund system, as interest receivable will be at a more modest rate, but this may be compensated by the fact that no loss will be incurred on the realisation of the investments, and the trouble involved in the investment of annual sums, together with incoming interest, is obviated.

The depreciation fund and insurance policy methods are the alternatives available when it is desired to give effect to interest on accumulated resources created by the annual provisions for depreciation. Interest accrues to the depreciation account, whether it be earned on investments, arise on

an insurance policy, or be created by debits to revenue when the funds are employed internally.

(h) The interest element may, however, be introduced from the opposite aspect, i.e. on the capital expended in the acquisition of assets. Under these conditions the asset is regarded as an expenditure of capital which may be assumed to yield a hypothetical rate of interest. The profit and loss account is credited with interest each year, calculated on the balance standing on the asset account. The corresponding debit is made to the asset account which is depreciated annually on the straight-line basis, as illustrated:—

Dr.		LEASE ACCOUNT.		Cr.	
Year 1		£	Year 1	£	
Jan. 1.	To Cash (acquisition of lease)	10,000	Dec. 31.	By Depreciation ..	850
Dec. 31.	" Profit and Loss Account (interest at 4%)	400		" Balance, c/d. ..	9,550
		<u>£10,400</u>			<u>£10,400</u>
Year 2			Year 2		
Jan. 1.	To Balance, b/d. ..	9,550	Dec. 31.	By Depreciation ..	850
Dec. 31.	" Profit and Loss Account (interest at 4%)	382		" Balance, c/d. ..	9,082
		<u>£9,932</u>			<u>£9,932</u>
Year 3					
Jan. 1.	To Balance, b/d. ..	9,082			

This process will be continued, the balance of the account being written off over the period of the lease.

It will be observed that depreciation must be adequate to write off the original capital outlay together with the annual debits in respect of interest. A constant depreciation charge falls to revenue each year, offset by gradually decreasing credits for interest. The *net* debit to the profit and loss account accordingly increases annually over the life of the asset in direct contrast to the diminishing balance method.

This scientific treatment of depreciation, known as the ANNUITY METHOD, may appear to be of academic interest only, but it does produce a definite reflection in the profit and loss account of interest on capital expended, and may

prove useful when alternative projects are undertaken and it is desired to compare results on an accurate basis.

The method is subject to criticism on the grounds of lack of prudence, and also that interest is merely a book entry. It also occasions difficulty in deciding the rate of interest appropriate to each category of asset at different dates, or in arbitrarily assuming whether an asset has been financed from shareholders' capital or from borrowed funds.

THE VARIOUS METHODS REVIEWED.

In this country, the straight-line, depreciation fund and diminishing balance methods are the orthodox systems, the first-named having become the most popular in recent years. The Institute recommended in 1945 that "*provision for depreciation should, in general, be computed on the straight-line method*" (Reserves for obsolescence and for increased replacement costs must, in accordance with the Eighth Schedule, para. 27, be kept distinct from provisions for depreciation.) The annual wear and tear allowance for income tax purposes is normally made on the reducing balance basis.

In America, the practice, although not compulsory, is to base depreciation on original cost. The straight-line method is consequently in almost universal use by industrial concerns in the United States and Canada and, as already stated, is nowadays officially encouraged in this country.

It may be that with such a wide choice of methods available, the reader is bewildered in his efforts to find the one most appropriate to the special circumstances surrounding a particular asset with which he is concerned.

To furnish some guidance in the practical application of the methods described, a list of the considerations which may be involved will first be tabulated, followed by some concrete examples showing the procedure recommended in each case:—

- (1) Estimated or actual life of asset.
- (2) Estimated residual value, if any.
- (3) Possibilities of obsolescence.
- (4) Whether renewals are periodic, or total (i.e. in entirety at one date).
- (5) Measure of permanency.
- (6) Nature of upkeep expenditure, e.g. constant, variable, increasing or decreasing.

- (7) Value of asset in relation to total assets.
- (8) Whether replacement will be necessary.
- (9) Extent to which interest should be taken into account
(a) on capital outlay, or (b) on accumulated provision.
- (10) Whether depreciation is required as an element of costing.

Subject to the overriding consideration that the straight-line method is advocated, except where special circumstances are present, the following table indicates conditions likely to arise in practice, and the most appropriate method to employ in each case. It is emphasised, however, that special circumstances may appertain in individual cases rendering some modification of the suggestions advisable, but from the information already given as to the advantages and deficiencies of each method, it is hoped that this table will prove useful:—

<i>Assets.</i>	<i>Circumstances.</i>	<i>Method Recommended.</i>
Leases.	Of short duration.	Straight-line.
Land.	Not constituting a large proportion of the total assets.	Ditto.
Buildings (Freehold and Leasehold).	Ditto.	Ditto.
Machines and mechanical equipment, including transport vehicles.	Necessitating gradually increasing expenditure on repairs.	Diminishing balance.
Ditto.	When repairs are variable but capable of estimation on an average annual basis.	Provision to cover repairs and renewals.
Ditto.	Comprising a number of small units falling due for replacement at intervals.	Straight-line.
Ditto.	When possibility of obsolescence is present.	Diminishing balance.
Ditto.	When of experimental character, or to be utilised for a limited period.	Ditto.

<i>Assets.</i>	<i>Circumstances.</i>	<i>Method Recommended.</i>
Ditto.	In business of staple product, subject to competition.	Production-unit.
Loose tools, casks, dies, stamps, bottles, containers, etc.	Liable to loss through pilferage, breakage, weather conditions, etc.	Direct appraisal.
Any asset.	Acquired as an investment, or as an experiment, or as an additional department, branch or process.	Annuity method.
Plant, machinery, leases, etc.	Of appreciable value, or when, for any reason, it is advisable to ensure that cash will be available for renewal.	Depreciation fund.
Ditto.	Ditto, when it is not desired to be troubled with external investment each year.	Insurance policy.
Any asset.	When the depreciation accumulations are being remuneratively employed within the business.	Depreciation fund, without external investment.

It will often happen that two or more of the above circumstances are combined in relation to one asset, in which event a choice between the methods recommended must be made at the reader's own discretion.

In the computation of estimated life, residual value, repairs and maintenance, the accountant will invariably need to act upon the advice of technical experts, either within the company or from information supplied by the makers of plant, machinery and equipment. Such estimates may, moreover, require revision from time to time in the light of experience.

OBSOLESCENCE.

Fixed assets become obsolete by reason of:—

- (a) Progressive invention, causing the retention of existing equipment to be unremunerative.

- (b) Change of consumers' habit, fashion or conditions, rendering assets redundant.
- (c) Competition, necessitating rationalisation.
- (d) Amalgamation, nationalisation, absorption or liquidation of company.

Obsolescence is an uncertain factor and the most that can be done on the acquisition of an asset is to consider the extent of its possibility in the future. As previously asserted the diminishing balance method recognises to a greater degree than any other the possibilities of obsolescence, but as an additional precaution in cases where obsolescence is a likelihood, it is recommended that a special reserve be created against this contingency, and shown as such in the balance sheet. As already mentioned, the Act requires that amounts *reserved* for obsolescence shall be shown *separately* from *provisions* for depreciation, and treated as reserves (Eighth Schedule, para. 27).

TAXATION.

Allowances for income tax and profits tax purposes may be claimed for plant, machinery, etc. These consist of ANNUAL WEAR AND TEAR ALLOWANCES calculated on the first cost of the asset for the year first in use and normally on the written-down value in subsequent years, plus an INITIAL ALLOWANCE for the year or years of *expenditure*. (The initial allowance, which was increased from 20 per cent. to 40 per cent. by the Finance Act, 1949, will, except for expenditure on trading ships under construction on 10th April, 1951, cease in April, 1952.)

When an asset is sold, destroyed or otherwise taken out of use, any part of the first cost less proceeds of disposal which has not been allowed by way of initial allowance or annual allowances may be claimed as a BALANCING ALLOWANCE. Conversely, if the allowances received exceed the first cost less residual proceeds, a BALANCING CHARGE will be made equivalent to the excess of tax allowances received over the net expenditure.

By way of simple illustration, it will be assumed that a company, which makes its accounts up to December each year, installed a machine in October, 1949, at a cost of £1,000, the machine being paid for in the same month. The basic annual allowance is assumed to be 10 per cent. (which, since April, 1946, has been subject to an increase of one-fourth). It is

assumed also that the machine will be disposed of for £300 in December, 1953:—

		£	£
	Cost (October, 1949)	1,000	
1950/51	Initial Allowance ($£1,000 \times 40\%$)	400	
	Annual Allowance ($£1,000 \times 10\% \times \frac{5}{4}$)	125	
			525
	Written-down value		475
1951/52	Annual Allowance ($£475 \times 10\% \times \frac{5}{4}$)		59
	W.D.V.		416
1952/53	Annual Allowance ($£416 \times 10\% \times \frac{5}{4}$)		52
	W.D.V.		364
1953/54	Annual Allowance ($£364 \times 10\% \times \frac{5}{4}$)		45
	W.D.V.		319
	PROCEEDS OF DISPOSAL		300
1954/55	Balancing Allowance		
			£19

If the second-hand value of the asset on disposal realises more than the written-down value for tax purposes (which frequently happens nowadays) a liability for BALANCING CHARGE will arise. Thus, if £600 be obtained for the machine in 1953, the balancing charge will be on £281 at the appropriate rates of tax.

It will be seen that over the life of an asset which is eligible for the foregoing capital allowances, the *net* cost of the asset is allowable for tax purposes.

An alternative to these capital allowances is the renewals basis, whereby renewals are charged annually in the tax computations.

Since April, 1946, an annual allowance has been claimable for *industrial buildings and structures* (excluding dwelling houses, retail shops, offices and hotels) at the rate of 2 per cent. per annum, plus an initial allowance of 10 per cent. in the year or years of expenditure, subject to a balancing allowance or balancing charge on disposal.

PROFIT OR LOSS ON SALE OF FIXED ASSETS.

When an asset is realised the cash received should be credited to the relevant asset account, any surplus or deficiency on the basis of the written-down value being adjusted in the account. Thus, if land purchased at a cost of £15,000, and depreciated at

the rate of 2 per cent. per annum on original price, be sold for £12,500 after the elapse of eleven years, the account for the last year would present the following appearance:—

Dr.	FREEHOLD LAND.		Cr.
	£		£
To Cost	15,000	By Depreciation ..	3,300
" Profit on sale ..	800	" Cash	12,500
	<u>£15,800</u>		<u>£15,800</u>

The profit of £800 may be carried to the credit of revenue in the current year provided such a course is not inconsistent with the company's Articles of Association and there is no deficiency on other assets. A more prudent procedure, however is to transfer the amount to the credit of a capital reserve account so that it may be available for capital losses such as future deficiencies in the sale of assets. When a loss is incurred on the sale of an asset, this should be written off in the profit and loss account.

The treatment of taxation on the disposal of assets due to the incidence of balancing allowances and balancing charges is illustrated on the opposite page.

APPRECIATION IN VALUE OF ASSETS.

The treatment of a surplus arising upon re-valuation or sale of a fixed asset is a matter of some importance. If the Articles do not prohibit, there is no legal objection to such accretion being transferred to the credit of profit and loss account in augmentation of the fund available for dividends provided *the appreciation arises from re-valuation of the assets as a whole, and such accretion is a realised surplus* (see *Lubbock v. British Bank of South America, Ltd.* on page 200).

In all other circumstances a surplus of this character should be credited to a capital reserve account.

AUDITORS' RESPONSIBILITIES IN RELATION TO DEPRECIATION.

English legislature has, perhaps wisely, held itself aloof from the subject of depreciation, and except for reference to the annual allowances in the Finance Acts, no attempt has been made to define depreciation, or provide any minimum requirements. The Act requires that the provision made for

depreciation each year shall be shown in the profit and loss account and if no provision is made *the fact shall be stated* (Eighth Schedule, paras. 12 and 14).

It is also provided that the accumulated amount provided or written-off for depreciation under each asset heading shall be shown in the balance sheet (Eighth Schedule, para. 5).

It speaks well for the conduct of management of companies in this country that, of recent years, cases in the courts on this subject have been comparatively rare. A later chapter in this book dealing with profits, refers to several cases appertaining to depreciation provisions in relation to the ascertainment of net revenue. A study of these will make it apparent that each case must be decided on its own merits, having regard to the particular circumstances which are present.

It is sometimes asked: "Does the inclusion of an unqualified report at the foot of the balance sheet, signed by the auditors, operate as an assurance to shareholders that adequate depreciation of fixed assets has been provided?"

To a large extent the answer is in the affirmative, since it is the duty of auditors to embody a suitable qualification in their report if, *in their opinion*, fixed assets have not been properly depreciated and if the company has not complied with the law in regard to the disclosure of depreciation provided. It must be stressed, however, that auditors are not valuers; they are not expected to possess a technical knowledge of assets which the company may hold, and provided they are of the opinion that the company's general policy in this respect is prudent and adequate and that the requirements of the Act have been complied with, they are entitled to be satisfied.

CURRENT ASSETS

BASIS OF VALUATION.

Current assets comprise:—

- (a) Assets held for the purpose of conversion into cash, e.g. debtors, bills receivable, stocks, temporary investments, etc.
- (b) Cash and bank balances.
- (c) Values which will automatically be consumed in the future operations of the company, e.g. rent, rates and insurances paid in advance, deposits paid, tax reserve certificates and advertising, development expenditure, etc. carried forward.

It can be anticipated that, under normal conditions, those under (a) and (c) will for the most part be liquidated in the succeeding year, and they should therefore be valued at their worth on the date of the balance sheet.

When the book value, i.e. the cost price, is greater than the market price the difference should normally be written off to the profit and loss account. Neglect to do this may result in the following year taking over assets at prices in excess of those at which they could be currently replaced.

The reverse procedure does not apply inasmuch as when the market price exceeds the cost price it is considered imprudent to take credit for the accretion as profit, since it is not a realised profit.

The general rule to adopt therefore when assessing current assets for inclusion in the balance sheet (unless exceptional circumstances call for some special treatment) is to value them at cost or market price, *whichever is the lower*. There are, however, some interesting exceptions to this rule and these are mentioned in this chapter.

Current assets are commonly known as FLOATING or CIRCULATING assets, these terms being self-explanatory.

The Act does not require a company to state how the amount of current assets is arrived at, but if, in the opinion of the directors, any of the current assets have not a value, on

realisation in the ordinary course of business, at least equal to the amount at which they are stated, the fact that the directors are of that opinion must be disclosed by way of memorandum note (Eighth Schedule, para. 11).

LIQUID RESOURCES.

A company's liquid resources at any date consist of its liquid assets, less current liabilities. Thus, in the balance sheet of Marks and Spencer, Ltd. on pages 370-371, the company's liquid resources on 31st March, 1951, may be said to be £1,124,172, computed as shown below:—

	£	£
Investments		1,374,135
Debtors and Amounts Paid in in Advance ..		931,000
Tax Reserve Certificates		1,500,000
Cash at Bankers and Cash in Hand		2,202,283
		6,007,418
Less Creditors and Accrued Charges	2,786,163	
Accrued Interest on Debenture Stock and		
Loan	18,981	
Provisions for Taxation	1,371,953	
Dividends	706,149	
		4,883,246
		£1,124,172

Some useful ratios and comments on the relationships of current assets and liquid assets to fixed assets, etc., are given in Chapter XVI.

STOCKS.

Stocks shown in the balance sheet may consist of:—

- (1) Goods in showrooms, shop or warehouse awaiting sale.
- (2) Raw materials.
- (3) Partly manufactured goods, or work in progress.
- (4) Stocks which have not reached maturity (e.g. tea, rubber, etc.).
- (5) Goods in the custody of agents, etc. awaiting sale and goods at branches.
- (6) Goods in the hands of customers "on sale or return" or on hire-purchase agreements.
- (7) Unused stocks of consumable stores, e.g. stationery, paints, maintenance materials, etc.

In the recommendations made by the Institute on the subject of the valuation of stock-in-trade, emphasis is laid upon the importance of applying a consistent basis of valuation from year to year so that the view of the real trend of trading results shall not be distorted. The basis adopted should be applied consistently regardless of the amount of profits available or losses sustained.

Any change in the basis of accounting must be stated by way of note if not otherwise shown (Eighth Schedule, para. 14) e.g. a change in the basis of valuation of stocks, work in progress, debtors, etc.

Stocks are usually shown in one figure in the balance sheet, but in America the Stock Exchanges require, as a condition of quotations, that a division be shown as between raw materials, work in progress and finished goods.

The special considerations to be applied in assessing the value of stock at the balance sheet date can conveniently be dealt with under the headings tabulated on the previous page:—

(1) Stocks of finished products awaiting sale should generally be valued at cost or market price, whichever is the lower, care being taken to exclude from the cost sheets any obsolete lines and goods which are not in saleable condition. A provision is recommended in respect of slow moving stocks in order to provide against losses. It frequently happens that some of these goods have a limited sales outlet, and are disposable only at "cut" prices.

In some businesses goods are valued on the stock sheets at selling prices and a suitable percentage deduction is made from the total of each category group of items sufficient to cover gross profit.

In the Institute's recommendation, previously referred to, it is advocated that cost should be calculated on such a basis as will show a fair view of the trend of results of the particular type of business concerned. Overheads should be restricted to such expenditure as has been incurred in bringing the stock to its existing condition and location.

It is recommended that market value should be calculated by reference to the price at which it is estimated the stock can be realised, after allowing for expenditure to be incurred before disposal.

Although *the lower of cost or market value* is the general rule, circumstances occasionally warrant departure from the

orthodox. For example, it is sometimes considered that when purchases have to be made for later delivery, their valuation at a balance sheet date may justifiably be at cost price irrespective of market value, since any fall in market price does not cause a trading loss but merely indicates that ultimate results under different trading conditions might have been better.

In more normal times it was a common practice in several trades to effect sales subject to an arrangement whereby a second-hand article was taken in part exchange, the balance of purchase price being payable by the purchaser. Cars, wireless sets, typewriters, and other products were frequently sold on this basis.

The undertaking given by the trader to buy a used article from a customer at a stated allowance—invariably a more favourable price than would be offered elsewhere—operates as an inducement to the user to exchange his property for a new and up-to-date model. When an inflated allowance is offered for the old product, this is tantamount to selling the new article below the list price or, in other words, passing a portion of the retailers' profit to the customer.

For book-keeping purposes, each transaction of this nature may be treated both as a sale and a purchase; the sale is then recorded at the full list price, and the purchase at the agreed exchange valuation.

A more practical procedure, however, is to debit cash and credit sales account with the net amount received, and subsequently debit purchases account and credit sales account with the market price of the goods taken in exchange.

If the second-hand article is marketed in the same financial year, any loss which may be incurred will automatically reflect itself in the profit and loss account, and go to offset profit on the original sale. When, however, second-hand goods are included in stock-in-trade at the end of the financial year, care should be taken to adjust book figures to market values wherever necessary, in order to obviate any unjustified inflation to the asset in the balance sheet.

(2) Raw materials subject to deterioration should be examined for defects before being valued and any materials which are unsuitable for present or future manufacturing requirements should be included at "scrap" prices.

(3) The basis of valuation of partly manufactured goods and work in progress offers certain alternatives. The extent

of approximation introduced into the computation of the cost price, depends primarily on the production records available.

Those companies which have the benefit of an efficiently organised system of cost accounting will apportion currently the indirect expense of production, i.e. factory oncost, over the goods produced. The book value of each unfinished job at any given date will consequently comprise the prime cost of materials used and productive labour, plus the whole of the overhead charges applicable to the job up to its present stage of manufacture.

If cost accounts are not available the cost of work in progress must be computed on an arbitrary basis, a percentage addition being made to the estimated prime cost (i.e. productive labour plus direct materials). Alternatively, the book valuation can be fixed at a figure which is approximately proportionate to the degree of progression, e.g. if an article costing £20 to manufacture has, at the balance sheet date, reached a stage representing two-thirds of the progress towards completion, the book figure will be approximately £13 6s. 8d.

These arbitrary methods may, however, fall somewhat short of accuracy as certain overheads, e.g. storekeeping, arise more particularly during the early stages of production.

Neglect to include factory overheads in the work in progress figure, results in an unfair charge to revenue, but those overheads which comprise fixed annual charges are sometimes excluded so as to avoid distortion of results between high production and low-production years. Some divergence of opinion exists as to whether office and administrative oncost should be similarly embodied and the practice in this connection varies, although generally such costs are better excluded.

Cash received on contracts in course of execution should be deducted from the work in progress figures, and the balance carried forward should not include any estimated profit unless contracts are well advanced towards completion, and sufficient reserves made for contingencies.

The Institute, in its recommendations on stock valuation, advocates that *"indirect or overhead expenditure, if included as part of the cost of partly processed or finished products, should be restricted to such expenditure as has been incurred in bringing the stock-in-trade to its existing condition and location. Stocks*

of by-products, the cost of which is unascertainable, should be valued at current selling price (or contracted sale price where applicable) after deducting expenses to be incurred before disposal. The cost of the main product should be reduced accordingly."

(4) Stocks which reach maturity only after a considerable number of years (such as tea, rubber, etc.) should be valued each year at a price estimated to be the ultimate proceeds, less estimated future expenditure, selling costs and proportion of profit.

If this basis is adopted, the fact should be clearly indicated in the accounts.

(5) Goods in the hands of agents, e.g. consignees abroad, may prove an exception to the general rule as to the valuation of current assets. When a portion of a consignment remains unsold at the end of the financial year, the cost price may be increased (subject to the condition mentioned later), by a proportion of the expenditure incurred in conveying the consignment to the location of the consignee.

This is illustrated by assuming that a company consigns to its agents, A. & Co., Bombay, 20 bales of cotton piece goods, at £50 per bale (cost price). The expenses incurred in freight, insurance, etc., amount to £48. In due course an account sales is received from A. & Co. advising the company that 15 bales have been sold in India for £1,000, the agent's commission and expenses to date amounting to £63. Five bales remain unsold at the date of the balance sheet, when the consignment account may appear in the ledger as shown below:—

Dr.		CONSIGNMENT TO A. & Co., BOMBAY.		Cr.	
	£			£	£
To Goods—20 bales at £50	1,000	By Sales—15 bales			1,000
" Freight, Insurance, etc.	48	" Stock, carried			
" Consignee's Expenses		down:			
and Commission	63	5 bales at £50		250	
" Profit, to Profit and		Proportion of			
Loss Account	151	Expenses, i.e.			
		5/20ths of £48		12	
					262
	<u>£1,262</u>				<u>£1,262</u>
To Stock, brought down	262				

It will be observed that the profit has been computed by the following process:—

	£	£
Gross Profit on 15 bales sold, i.e. £1,000—£750.. ..		250
Less 15/20ths of Expenses	36	
Consignee's Commission and Expenses on 15 bales sold	63	
	—	99
		<u>£151</u>

This calculation is equitable so far as the profit and loss account of the current year is concerned, but it must not be overlooked that the profit has been reckoned by including £12 expenses in the balance carried down. The balance sheet figure has accordingly been “loaded” with £12, being the proportion of expenses attributable to the goods on hand in the consignee’s warehouse.

This violation of a principle already emphasised is justifiable only if the goods can conscientiously be asserted to represent greater value to the company when in the hands of the agent than in the showrooms at home. If any doubt exists in the minds of those responsible, as to the ability of the consignee to realise a satisfactory price on the balance, i.e. 5 bales, a portion of the book value should be written off in the current year. Actually, the principle of cost or market value is applied to the goods *at the place where they are situated*. The same rule may be applied to goods at branches.

(6) Goods in the hands of prospective customers “on sale or return” should be valued at cost or market price whichever is the lower, the aggregate figure being reduced by a percentage (based on past experience) to cover possible losses arising through the inability of the company to recover goods in satisfactory condition when necessity arises. Some accountants consider this provision unnecessary as such losses are more equitably charged in the period when the sales occur.

In valuing goods sold on hire-purchase agreements, which are not fully paid for at the date of the balance sheet, two entirely different procedures appertain in practice.

These methods are best exemplified by confining the hire-purchase sales account to the record of an isolated sale.

A piano is sold for £36, payable over 36 months at £1 per

month. The cash selling price of the piano is £33, and the cost price £24. The entries by method No. 1 are set out below:—

<i>Dr.</i>		HIRE PURCHASE SALES ACCOUNT.		<i>Cr.</i>
<i>Year 1.</i>		£		£
To Sale (at Cost price) ..	24	By Cash		12
" Profit, carried to Profit and Loss Account ..	4	" Stock in Customer's hands at Cost price, i.e. 2/3rds of £24 ..		16
		<u>£28</u>		<u>£28</u>
<i>Year 2.</i>				
To Stock, brought down..	16	By Cash		12
" Profit, carried to Profit and Loss Account ..	4	" Stock in Customer's hands at Cost price, i.e. 1/3rd of £24 ..		8
		<u>£20</u>		<u>£20</u>
<i>Year 3.</i>				
To Stock, brought down..	8	By Cash		12
" Profit, carried to Profit and Loss Account ..	4			
		<u>£12</u>		<u>£12</u>

The total gain to the company, £12, made up of £9 profit on the sale and £3 interest is spread equally over the whole period, i.e. £4 per annum.

By method No. 2 the piano is taken into the account at the cash selling price as illustrated:—

<i>Dr.</i>		HIRE PURCHASE SALES ACCOUNT.		<i>Cr.</i>
<i>Year 1.</i>		£		£
To Sale (at cash selling price)	33	By Cash		12
" Profit, carried to Profit and Loss Account ..	1	" Stock in Customer's hands, i.e. 2/3rds of £33		22
		<u>£34</u>		<u>£34</u>
<i>Year 2.</i>				
To Stock, brought down..	22	By Cash		12
" Profit, carried to Profit and Loss Account ..	1	" Stock in Customer's hands, i.e. 1/3rd of £33		11
		<u>£23</u>		<u>£23</u>

<i>Year 3.</i>			
To Stock, brought down..	11	By Cash	12
" Profit, carried to Profit and Loss Account ..	1		
	<u>£12</u>		<u>£12</u>

This method has the effect of spreading the profit of £12 over the three years as shown below:—

<i>Year 1.</i> Credit to Profit and Loss Account:—				£	£
			Profit on Sale ..	9	
			Hire-purchase Interest	1	
				—	10
<i>Year 2.</i>	"	"	"	"	1
<i>Year 3.</i>	"	"	"	"	1
			TOTAL		<u>12</u>

The second method has more to commend it in most instances (despite its less frequent application in practice), since all the expenditure necessary to effect the sale falls in the first year, the subsequent years being concerned only with the collection of part of the proceeds.

The balance sheet figures for goods in customers' hands on hire purchase contracts will be:—

				<i>Method No. 1.</i>	<i>Method No. 2.</i>
				£	£
<i>Year 1</i>	..	..	..	16	22
<i>Year 2</i>	..	..	..	8	11

It will be noticed that the two procedures produce appreciably different valuations.

Although it is incorrect technically to show in the balance sheet an amount outstanding as debts due from hire-purchase customers, since the agreement is one of hire only, it may be assumed that, in most cases, the hirer intends to continue payment until the property becomes his own. An adequate provision for losses should, however, be made.

Sales by instalment-payment do not suffer this theoretical disadvantage as the legal ownership in the goods passes to the customer at the time of the sale, the unpaid portion of the selling price being a debt upon which the company can sue if necessity arises in the same manner as an ordinary debt.

(7) Stocks of consumable stores on hand should be carried down in the appropriate accounts at a conservative valuation.

The balances are, in reality, items of deferred expenditure and can be likened to rent, advertising, etc. carried forward.

As already stated, emphasis was laid by the Institute on the need for observing a consistent policy in the valuation of stocks, whatever form they may take and whatever basis may be adopted. The measure of profits available or losses sustained should be disregarded. Any reduction in stock values which exceeds the provisions advocated IS A RESERVE AND SHOULD BE SHOWN AS SUCH IN THE ACCOUNTS. The dubious practice of creating excessive and hidden provisions in successful years, which has not been uncommon in the past, is prohibited by the Act (Eighth Schedule, para. 27), which stipulates that any amount provided which is *in excess of that which is reasonably necessary shall be disclosed as a reserve* (i.e. as distinct from a *provision*). The note which is required by the Act to be shown on the profit and loss account of *any change in the basis of accounting* (Eighth Schedule, para. 14) applies to the valuation of stock.

AUDITORS' DUTIES IN RELATION TO CERTIFICATION OF STOCKS.

The value of stock-in-trade is usually certified by directors or other responsible officials of the company. The Court of Appeal, held, in the well-known *Kingston Cotton Mill* case (1896), that it is not the business of the auditor to take stock, and also that an auditor is not a valuer. He is entitled, *in the absence of suspicious circumstances*, to place reliance upon the statements or certificates of responsible officials in regard to the existence and value of the stocks.

The doctrine enunciated in this case has been modified in recent years, and reference should be made to the *Westminster Road Construction* case on page 215.

PROVISIONS FOR LOSSES IN COLLECTION.

The aggregate of the balances on debtors' accounts and the value of bills receivable awaiting maturity should be carried over to the next financial year at the amounts which it may reasonably be anticipated will accrue to the company in the liquidation of these debts. It must not be overlooked that the entire profit arising on a credit sale is taken credit for at the time of the sale. If the proceeds are not collected at the end of the financial year dividends may be paid on the strength of book profits which are never realised.

It behoves companies therefore to make adequate provision for bad debts, also legal and other costs which may be incurred in the collection of open debts and bills of exchange. This provision takes the form of an estimate of the losses which are likely to accrue in this connection, and is debited to the profit and loss account. The debtors' figure in the balance sheet is correspondingly reduced.

A detailed schedule of debts outstanding should be prepared, the date contracted and particulars of any payments on account being appended in each case. Explanatory notes such as "adjudicated bankrupt," "in liquidation," "composition with creditors," "in solicitors' hands," etc. should be included where applicable. It will then be possible to divide the aggregate debtors' figure into separate totals representing "good," "probably good," "doubtful" and "very doubtful" debts. By calculating a small, medium and large percentage rate on the three last-named respectively, an approximation to accuracy can be achieved in constructing the provision for bad and doubtful debts.

It is not possible to tabulate any hard and fast rule as to what constitutes a doubtful debt. The circumstances in each case must determine the method to be adopted. For instance, an electricity undertaking's arrears of quarterly accounts will be of comparatively modest dimensions. Unless the consumer has departed from his premises it can be assumed that the fear of having supplies cut off will act as a deterrent to avoiding his obligations. Again, a West End tailor might regard a three-year-old debt as good if the customer consistently discharged his liabilities in rotation, even if his payments were belated. The length of credit allowed, the class and status of customers, the regularity of orders received, and the facility by which the company can keep in touch with debtors are all features which must be considered when estimating future losses of this character.

If it is the practice of the company to allow discount for cash payment within a stipulated period, a further deduction may be made from the sundry debtors to provide for this expense. But while no divergence of opinion exists among accountants as to the necessity for making provision for bad debts, there are two schools of thought on the subject of a provision for cash discounts.

Some accountants contend that the principles involved in the two cases do not materially differ, and that if the sundry debtors appear in the books at £50,000, and in the normal collection of this amount 5 per cent. cash discount has to be allowed on debts aggregating £20,000, the value of the asset is £49,000 not £50,000.

The contrary, and more popular view, is that the cost of cash discount should fall in the year when the debt is collected, and not in the year when the sale or service was executed. The force of this argument lies in the fact that, by reason of the incentive given to the debtors to remit promptly, the year of collection benefits by enjoying the use of the funds for a longer period.

When it is decided to make provision for cash discount on sundry debtors it would seem consistent to adopt a like practice in respect of cash discount on sundry creditors. If therefore the cash discount period has not expired in respect of certain liabilities, and there is a likelihood that they will be extinguished promptly, a suitable deduction should be made from creditors on the liabilities side. The amount so deducted will be *credited* to revenue.

The profit and loss account and balance sheet below illustrate the book entries necessary to give effect to provisions for bad debts and discounts:—

Dr.		PROFIT AND LOSS ACCOUNT		Cr.	
		FOR YEAR ENDED 31ST DECEMBER, 1951.			
	£	£		£	£
To Provision for Bad Debts at 31st Dec., 1951 ..	1,800		By Provision for Discount on Creditors at 31st Dec., 1951	1,000	
Less Balance already existing (i.e. at 31st Dec., 1950) ..	1,690		Less Balance at 31st Dec., 1950	970	
	<u> </u>	110		<u> </u>	30
„ Provision for Discounts on Debtors, at 31st Dec., 1951 ..	1,200				
Less Balance at 31st Dec., 1950	1,120				
	<u> </u>	80			

BALANCE SHEET, 31ST DECEMBER, 1951.

	£	£		£	£
Sundry Creditors	20,000		Sundry Debtors	60,000	
Less Provision for			Less Provision for		
Discounts ..	1,000		Bad Debts ..	1,800	
	<u> </u>	19,000		<u> </u>	58,200
			Less Provision for		
			Discounts ..	1,200	
				<u> </u>	57,000

It will be noticed that the bad debts provision is first deducted from sundry debtors, and the discounts provision subsequently subtracted from the estimated good debts. The reason for this practice is that the portion of book debts provided for as irrecoverable obviously needs no consideration when the possibilities of cash discount are reviewed.

In the case of each of the three provisions included in the above balance sheet, the amount of the provision is increased by an entry in the profit and loss account. In those years, however, when the existing provision is in excess of the amount required, the requisite reduction will appear on the *opposite side* of the profit and loss account to that shown.

Provisions for bad debts and discounts are not normally disclosed in the published balance sheet, the net figures for sundry debtors and creditors respectively being shown.

TAX RESERVE CERTIFICATES.

The amount of tax reserve certificates held should be shown *as a separate item* in the balance sheet.

These certificates (upon which interest is allowed at the rate of three-quarters of one per cent. *free of tax*) can be used for the payment of income tax (except under schedule E), sur-tax, etc.

LOANS TO DIRECTORS AND OFFICERS.

It was a common practice prior to 1929, for companies to include loans to directors and/or officers in the amount of sundry debtors shown in the balance sheet.

The Act of 1929, however, provided that the accounts to be laid before the company in general meeting should contain particulars showing:—

- (a) The amount of loans which, during the period covered by the accounts, had been made by the company to any director or officer thereof; also

- (b) The amount of loans made by any person to any director or officer during the period of the accounts under a guarantee from or on security provided by the company; also
- (c) Loans made under (a) and (b) which were repaid during the period; also
- (d) The amount of any such loans made before the period of the accounts and remaining outstanding at the end of the period.

It will be seen that not only were loans made before or during the period under review and remaining outstanding at the end of the period required to be disclosed, but also *loans repaid during the period*. It was therefore impossible for directors or officers who had received a loan to evade the section by paying it off before the end of the accounting period.

These provisions did not apply:—

- (1) In the case of a company, the ordinary business of which includes the lending of money, to a loan made in the ordinary course of business.
- (2) To loans made to employees not exceeding £2,000 and certified by the directors to have been made in accordance with the usual practice of the company.

If the requisite information was not contained in the accounts it was the duty of the auditors to include in their report a statement giving the required particulars.

In the Act of 1948 a distinction is made between loans to *directors* and to *officers*. *Loans to directors (except when arising under (1) above and as stated on the next page) are NOT permitted, whether made by a company or by any of its subsidiaries* (section 190). Loans made before the passing of the Act and still outstanding are not referred to in the Act, but it would seem unreasonable to assume that companies are required to demand repayment. It is suggested that such outstanding loans should be clearly indicated in the balance sheet, e.g. "Loans to Directors prior to 1st July, 1948," or when there has been part-repayment, the amount at July, 1948, should appear and the amount repaid shown as a deduction (the repayments being divided between the current year and previous years). The requirements of the 1929 Act relating to loans to officers are not amended,

except that the provisions are extended to loans made to officers *by (or under a guarantee from) subsidiary companies* and to loans made to persons who subsequently become officers during the financial year (section 197).

The foregoing restriction on loans to directors does not apply to an exempt private company, nor to loans by a subsidiary, where the director is its holding company, nor to loans made to provide a director with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or to enable him properly to perform his duties as an officer of the company (section 190). For example, it may be desirable for a director to live near the company's offices and the company may advance part or whole of the purchase price of a house to the director for that purpose or a director may be required to purchase a piece of land for re-sale to the company immediately afterwards, in circumstances where it might be imprudent for the company to enter the market as a prospective purchaser.

Loans to a director to meet expenditure necessitated by his duties must, if not previously authorised in general meeting, or approved by the company at or before the next annual general meeting, be repaid within six months after that meeting (section 190).

The section does not appear to prohibit a loan by a holding company to a subsidiary company's director who is not also a director of the holding company, or a loan to the director of a fellow subsidiary company who is not a director of the company making the loan.

CHAPTER V

INVESTMENTS

ANALYSIS OF INVESTMENTS.

External investments appear in the balance sheet of many companies, the securities being held for various purposes. They may be of a temporary or permanent character, and represent either capital or revenue funds. Again, the securities may be entirely external, or comprise shares in, or loans to, companies operating within the same group of undertakings.

The purposes for which investments are held may be classified as under:—

- (1) As a temporary accommodation for cash in excess of immediate future requirements, after allowing a margin for contingent expenditure. This obviates leaving balances at a negligible rate of interest on deposit account, beyond an amount necessary to meet all reasonable current demands.
- (2) When it is considered expedient to invest reserves in outside investments. (The advisability, and otherwise, of adopting this practice is fully discussed on page 140.)
- (3) To represent a sinking fund when the depreciation fund method of depreciation is used, as described in Chapter III. Alternatively, the sinking fund may be created to redeem a loan, e.g. debentures.
- (4) As a means of employing capital resources not required for use in the business.
- (5) For the temporary accommodation of capital funds until such time as they are needed for the purpose created.
- (6) As an investment of specific funds held by the company, in the capacity of trustee, e.g. staff provident funds.
- (7) When financial aid is afforded to other companies, by loans, for trade purposes.
- (8) To acquire a financial interest in allied or competitive companies, as a method of obtaining financial control.

Each of these purposes will be considered separately, and the particular types of investment most suitable to the circumstances will be recommended.

In categories (1) and (5), the most essential requirement, when selecting a medium for temporary investment, is the facility for prompt withdrawal. Idle cash may advantageously be used to purchase sub-units in a unit trust. Alternatively, no objection can be taken to securities which have a ready market, e.g. shares and debentures of well-known industrial concerns quoted daily in the Stock Exchange lists. The rate of interest earned is a secondary consideration as, at its lowest, a greater income will normally be derived than that obtainable on a bank deposit.

Investments purchased out of cash representing accumulated profits, i.e. a reserve fund, should consist, in the main, of gilt-edged securities such as government stocks, corporation loans, etc. A small proportion of sound commercial equities may perhaps be included for "mixing" purposes, in order to increase the over-all yield. The inclusion of any speculative securities might jeopardise the reserve fund, which would, as a matter of course, have to bear any loss on realisation. For this purpose also, net annual yield is not, in normal circumstances, the primary consideration.

The same considerations apply to reserves held to meet increased costs of replacing assets, except that when it is possible to purchase investments likely to respond to the effects of inflation a real advantage is derived.

When the asset under notice is acquired for sinking fund purposes, those securities which afford a fixed income should be selected, so that the cumulative value of the investments at a given future date shall produce, as near as possible, a pre-determined sum. A further point to remember is that the investment should be available for annual additions at a similar purchase price. If this is overlooked, the trouble involved in finding corresponding sources of investment will arise from time to time. Government and Corporation stocks and sound industrial debentures offer the best choice in this connection.

The employment of capital sums held in excess of requirements presents the greatest difficulty. Such capital surplus is brought about: (a) by the cessation of certain branches or departments, thereby releasing capital when the assets are

sold; (b) by new and improved processes of production rendering assets which involve less capital outlay adequate for the purposes of manufacture; or (c) contraction of the company's activities, giving rise to a redundancy of assets.

If cash resources thus made available are allowed to remain dormant, the company will experience difficulty in maintaining dividends at rates commensurate with those paid in previous years. Investment in outside securities is therefore almost inevitable, but it will usually be found that, to obtain an income corresponding with the dividend paid on the ordinary shares, considerable risks will need to be incurred, thereby endangering the capital involved. It would seem a better course to adopt, when there is little likelihood of the capital being employed for the company's future purposes, to effect a reduction of capital pursuant to section 66 of the Act (see Chapter VIII).

The problem of utilising capital resources in excess of requirements does not arise so frequently nowadays as the reverse problem of finding sufficient capital to keep pace with the rising costs of commodities and capital equipment.

When staff provident funds are invested outside the business, as is customary, security of capital is of paramount importance. The by-laws of the staff club or society may in fact provide that the company shall invest its funds in trustee securities, but even when this is not the case, the utmost care must be exercised in the selection of investments to ensure that the possibility of depreciation is reduced to a minimum. An example of investments held for this purpose will be seen in the balance sheet of Aerated Bread Company, Ltd. on pages 364-365, where the staff pension fund of £88,663 is represented in the main by specific investments of £60,000 on the opposite side of the statement.

Investments of an entirely different character are those considered expedient by the exigencies of the particular production or trading circumstances appertaining to the company. Examples of the propriety of rendering financial aid by subscription to the shares in, or granting of loans to other undertakings, are seen whenever assistance is given to concerns providing raw materials, or component parts for manufacture, or to an organisation which engages in distribution of the company's products.

The value of such investments must not be judged by the measure of income receivable, but by the advantage accruing

to the company in safeguarding its supplies or its market. Many examples could be quoted where the benefit derived by a company from the employment of its funds in this manner produces a handsome return in the form of increased profits.

Finally, when shares in other companies are acquired, not with the primary object of rendering financial assistance to allied undertakings, but to obtain a controlling interest in them, the companies are termed subsidiary companies, and the concern holding the shares is known as the parent company.

The important principles and legal requirements relative to holding companies are dealt with in the next chapter.

BASIS OF VALUATION FOR BALANCE SHEET PURPOSES.

The basis of valuation of investments at the close of the financial year generally conforms to the rules already set forth in earlier chapters relative to the valuation of fixed and current assets respectively. Investments usually come within the category of fixed assets, the exception in this respect being when the securities constitute a temporary accommodation for idle cash, and, in the opinion of many accountants, when they represent accumulated profits (e.g. a reserve fund).

In such instances the asset should appear in the balance sheet at cost or market price, whichever is the lower, although minor temporary fluctuations may be disregarded.

Investments falling within any of the other classifications enumerated on the foregoing pages should be shown at cost, and where any provision for long-term diminution of value has been made this should be shown. Fluctuations in market value from year to year should not be allowed to affect current profits. It is a customary and commendable practice to append a note on the balance sheet indicating the aggregate value of investments at market prices as at the close of the financial year, and, as stated on the next page, this is compulsory under the Act in so far as quotations are available. When this procedure is adopted it should not be overlooked that most of the securities will be quoted "cum-div.," i.e. including accrued dividend or interest for a portion of the last half-year. The income accruing actually belongs to revenue and, although this factor is not normally observed in practice, or referred to in accountancy text-books, it should be excluded when arriving at the market value of investments for the purposes of this

memorandum note. Many investment companies show investments in detail either in the balance sheet or in an accompanying schedule and this practice might with advantage be more generally followed by trading companies.

LEGAL REQUIREMENTS.

The obligations imposed upon companies by the Act in regard to showing as separate items in the balance sheet: (a) shares in; (b) amounts owing by subsidiary companies, and (c) amounts owing to subsidiary companies, will be referred to in the next chapter.

Companies are required by the Eighth Schedule (para. 8) to show investments separately in the balance sheet under the following headings:

- (a) The aggregate amount of trade investments (other than investments in subsidiary companies).
- (b) The aggregate amount of other quoted investments.
- (c) The aggregate amount of other unquoted investments.

A quoted investment is defined in the Eighth Schedule (para. 28) as "*an investment as respects which there has been granted a quotation or permission to deal on a recognised stock exchange, or on any stock exchange of repute outside Great Britain.*" By section 455 a "recognised stock exchange" means one which is recognised for the purposes of the Prevention of Fraud (Investments) Act, 1939.

In the case of (b), it is provided that the aggregate market value shall be required to be stated by way of a note if it differs from the balance sheet amount, also the stock exchange value of any investments of which the market value is shown and is taken as being higher than their stock exchange value (para. 11).

The requirements for holding companies are set out in Chapter VI.

The amount of income from investments, *distinguishing between trade investments and other investments*, must be disclosed in the profit and loss account (Eighth Schedule, para. 12).

TRADE INVESTMENTS.

The Act gives no definition of the term "Trade Investment" and difficulty may arise in some cases in deciding whether an investment comes within this category or not. Until some

definition is available here, that embodied in the report of the Millin Commission of Enquiry into South African Company Law might usefully be observed, i.e. "an investment by a company in the shares or debentures of another company, not being its subsidiary, for the purpose of enhancing or facilitating the trade or business of the first company; and no investment shall be deemed to be a trade investment which does not constitute and is not treated as a fixed asset."

AUDITORS' DUTIES.

It is the duty of auditors to satisfy themselves as to the existence of specific investments. The documentary evidence may be in the form of certificates, bonds, allotment letters, or scrip; or the investment may be in inscribed stock. They should see that the certificates are made out in the company's name, and be properly sealed and signed. Bonds may also be registered, or may be to bearer; in the latter case the auditor should see that all coupons for payment of interest not due are attached to the bond.

Scrip is issued for shares and stock not fully paid up, and the auditor should see that it bears the signature of the banker for each call which has become due for payment.

INVESTMENT TRUST AND FINANCE COMPANIES.

Investments constitute the principal asset in the balance sheet of those companies which qualify for inclusion under the above heading. Apart from the balances of cash in hand and at bank, this asset may be the only item appearing on the right-hand side of the balance sheet.

The function of investment trust companies is to spread capital contributed by the shareholders over a diversity of investments, the income derived being divided among the members in accordance with the dividend rights attaching to the various classes of shares. Such companies treat realised surpluses on the sale of investments as capital profits, and this rule is usually made obligatory by being embodied in the Memorandum and Articles of Association. Profits on capital, handled through realisation—redemption or sale—are retained in the undertaking.

These profits are not therefore available for dividends and cannot be treated as revenue. Their normal appropriation is to the extension of existing investments, which operation

tends to increase income in future years. There is, however, no objection to the capitalisation of such surpluses in the form of an issue of bonus shares (subject to the statutory conditions set out on page 251).

Finance companies differ from investment trusts in that investments are treated as current assets. The asset constitutes stock-in-trade and should be valued accordingly. The receipt of income from investments is not the sole function of such companies; more speculatively, they seek the reward of astute purchasing in the form of profit on redemption and sale. This surplus is accordingly a revenue item.

The excess of investment values (at market prices), at the end of the financial year, over that at the beginning of the year, comprises income in the accounts of a finance company, and, moreover, attracts income tax. This applies also to realised profit on sales.

By way of contrast, capital profit derived from accretions to the investment figure, on the part of an investment trust company (whether realised or not), escapes tax, and, as stated above, is not available for dividend purposes.

Similarly, when dealing with depreciation of investments, the investment trust may legally disregard such loss, and distribute the income earned on revenue account without providing for it. Finance companies, on the other hand, would experience difficulty in maintaining that dividends had not been paid out of capital unless provision was made for this loss in asset values.

HOLDING COMPANIES.

The practice whereby a company acquires a controlling interest in one or more other companies has become much more common in recent years and the Act contains many important new requirements on this subject. This type of investment is dealt with in the next chapter, devoted exclusively to holding companies and group (including consolidated) accounts.

CHAPTER VI

HOLDING COMPANIES AND GROUP ACCOUNTS

The "holding company" method of control has grown extensively during the past twenty years. When the 1929 Act was passed the practices, now so prevalent, of operating through subsidiaries, of enlarging activities by the purchase of shares in established companies, of achieving economies by the financial interlocking of companies with common interests, of reducing competition by the acquisition of capital in rival concerns, etc., were only in their comparatively early stages in this country. In America holding companies have been in existence since before the opening of the century.

Statistics are not available of the number of holding companies on the register each year (and would not be altogether reliable according to present standards if they were, owing to the recently changed statutory definitions of such concerns in this country), but the upward curve during the last two decades has certainly been very steep.

DEFICIENCIES IN THE LAW PRIOR TO 1948.

That the provisions in the Act of 1929 relating to the accounts of holding companies were grossly inadequate in the light of modern conditions is not surprising. These provisions were contained in sections 125, 126 and 127.

Section 125 has not been amended and it is still compulsory to show separately the aggregate amount of shares in and amounts owing (whether on account of loan or otherwise) *by* subsidiary companies in a company's balance sheet (shares and indebtedness to be shown separately) and conversely, the aggregate amount owing *to* subsidiaries must be distinguished from other liabilities.

These requirements are now contained in the Eighth Schedule (para. 15) and apply to all holding companies, whether subsidiaries of other companies or not.

The other two sections of the 1929 Act referred to have been repealed. Section 126 (which never achieved any useful

purpose) related to the meaningless statement which had to be annexed to the balance sheet stating how the *aggregate* profits and losses of subsidiaries had been dealt with, without disclosing the amount of any such profits or losses or giving any information beyond such vague statements as:

"The profits of subsidiary companies have been included only to the extent of dividends actually declared."

"The profits and losses of the subsidiary companies have been provided for in the above accounts."

etc. This ineffectual section has been replaced by several important and, on the whole, satisfactory provisions in the 1948 Act and these are explained in this chapter.

Section 127 contained the definition of a subsidiary company. This has been superseded by the new definitions of holding and subsidiary companies contained in section 154 of the new Act. These definitions are examined later.

The position prior to 1948 was most unsatisfactory. To take what is admittedly an extreme example, a balance sheet of a company which functioned solely as a holding company, could have been presented in the following meagre form and still have complied with the Act of 1929:—

BALANCE SHEET ON 31ST DECEMBER, 1947.

	£		£
<i>Authorised and Issued Capital:</i>		<i>Investments in, and Advances to Subsidiary Companies:</i>	
200,000 Preference Shares of £1 each, fully-paid	200,000	Investment, at Cost	820,000
800,000 Ordinary Shares of £1 each, fully-paid	800,000	Advances	190,000
		Cash	10,000
Profit and Loss Account	20,000		
	<u>£1,020,000</u>		<u>£1,020,000</u>

This illustrates how shareholders could be deprived of almost all information relative to the assets and liabilities of the company to which they had subscribed capital.

The requirement of the 1948 Act that, subject to the exceptions and alternatives mentioned on the pages which follow, holding companies must now present group accounts

in the form of a consolidated profit and loss account and consolidated balance sheet, remedies this defect in the law as it stood until July, 1948.

IMPROVED LEGISLATION.

The Act seeks to furnish shareholders of a holding company, whenever possible, with the information they would have if the entire group were constituted as a single undertaking. While a consolidated profit and loss account and a consolidated balance sheet of the group as a whole (with inter-company transactions eliminated) is normally the ideal form of presenting the accounts, it is recognised that in some cases this is not practicable, and in others not appropriate.

Although the 1929 Act went a long way towards the reform of company balance sheets, it was possible, as illustrated on the previous page, for a company to contract out of all the relevant requirements by operating through a subsidiary which might hold almost all the tangible assets and earn all the profit. Beyond the information which had to be given under the old section 125 (and section 126, for what it was worth), already referred to, shareholders usually received no details of the financial state or the revenue position of the subsidiary.

DIFFICULTIES OF CONSOLIDATION.

Although the weakness of the law was generally recognised, there were many who considered that the obstacles in the way of drafting adequate and satisfactory amendments were insurmountable. That the very real difficulties and problems have been overcome in the new legislation reflects great credit on all concerned in the drafting of the amending Act of 1947 (now, of course, incorporated in the 1948 Act).

Let us consider some of the main problems which had to be faced and then examine how these difficulties have been overcome:

In the first place, all companies within a group may not close their accounts on the same date, and while it is usually practicable for subsidiaries and/or the parent company to change their balance sheet dates, there are cases where this may result in hardship or even loss. Seasonal conditions appertaining to many trades may render it most inconvenient for some companies to change their financial year-end to the common group date, involving stocktaking and additional clerical work during a busy period. In other instances a

change in the financial period may be disadvantageous for income tax purposes owing to the incidence of computations under Schedule D.

The Cohen Committee had regard to these difficulties and cited also the position which might arise when the accounts of some subsidiaries were not available, e.g. when they were operating in a country involved in civil war; or when a subsidiary was hopelessly insolvent and the holding company, being under no liability to meet its debts, was not willing to do so; or if the assets of a subsidiary company consisted largely of balances in a foreign country which, owing to exchange restrictions, could not be transferred, etc.

Consolidated accounts may be inappropriate when the businesses carried on by the various companies in a group are so diverse as to render a comprehensive consolidation misleading. Sometimes two or more sets of consolidated accounts for the group, each embracing the result and affairs of subsidiaries with common functions, will prove to be a satisfactory procedure. Again, the fairly common practice in America of submitting a separate consolidation of foreign subsidiaries may be an appropriate form of presentation.

In other cases a company's interest in a subsidiary may constitute such an insignificant proportion of its total assets as to render consolidation of the figures unnecessary. Again, circumstances may arise when the preparation of group figures would involve expense or delay out of all proportion to their value to shareholders, e.g. where there are relatively insignificant interests in subsidiaries domiciled abroad.

ALTERNATIVES TO CONSOLIDATION.

While a consolidated profit and loss account and a consolidated balance sheet is now the normal form of submitting the accounts of a group, the Act has regard to the foregoing difficulties by permitting certain alternatives and exceptions (section 151). If the directors of a company should be of the opinion that the same or equivalent information will be more readily appreciated by the members in another form, they may adopt that form. For example, group accounts may consist of more than one set of consolidated accounts (dealing respectively with the company and one group of subsidiaries, and with other groups of subsidiaries), or of separate accounts for each subsidiary, or by the inclusion of

statements expanding the information about subsidiaries in the company's own accounts. Similarly, any combination of these forms may be adopted.

Group accounts may be wholly or partly incorporated in the company's own balance sheet and profit and loss account.

These alternatives are, of course, designed to meet exceptional cases and illustrate how, by a considerable measure of flexibility, the Act has overcome the many difficulties which are liable to arise. There is a danger that this elasticity may leave some loopholes whereby companies may evade the spirit of the new requirements. Amendments, either when a new Act is passed or, more likely, by the Board of Trade under the powers conferred under section 454, may be necessary.

The term "Group Accounts" is an apt expression to embrace all the alternative forms of presentation which are now available. It will be observed that exercise of the alternatives is an option which rests with the directors.

Most of the alternatives referred to in the Act are intended to meet exceptional conditions because in normal circumstances they are less satisfactory than the publication of consolidated accounts. The fact that the vast majority of holding companies prepare their group accounts in the form of consolidated accounts is evidence of this. For example, the issue of a booklet containing the separate accounts of the parent company and each of its subsidiaries will usually be of less value to shareholders than consolidated accounts. A view of the results and financial position of the group may be most difficult to perceive from this form. Inter-company transactions, which will not be eliminated (and may not be easily apparent), may prove misleading. And if, perhaps for administrative reasons, the earnings of the group are largely concentrated in one or more subsidiaries, the relative value of subsidiaries to the holding company may be obscured.

An example of an alternative to consolidated accounts will be seen in the Statement in respect of Interests in Subsidiaries of Marks and Spencer, Ltd., on page 374.

EXCEPTIONS FROM THE LEGAL REQUIREMENTS.

The Act provides certain exceptions from the obligation to prepare group accounts (section 150). These are not required where the company is, at the end of its financial year, the wholly-owned subsidiary of another body corporate, that is to

say, it has no members other than its parent concern or the parent concern's wholly-owned subsidiaries or the nominees of those companies. (In such circumstances, of course, the affairs of the company and its subsidiaries would normally be incorporated in the group accounts of the larger group as a whole). It is worthy of notice here that the recently formed nationalised boards are "bodies corporate" for this purpose and several have in fact a large number of subsidiaries incorporated under the Act.

Exceptions are also provided where it would be impracticable or of no real value owing to the insignificant amounts involved,* or would involve undue expense or delay, or would be misleading, to include a subsidiary in group accounts and also (with the approval of the Board of Trade) when it would be harmful, or when the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking.

Opinions may differ as to when the amounts involved may be regarded as "insignificant" and the Act gives no assistance. It may furnish some guidance to mention that, in America, where there are less than 5 per cent of the total assets invested in subsidiaries or where the assets of the subsidiary are less than 5 per cent. of the combined assets of the group or where the turnover of a subsidiary is less than 5 per cent. of the group turnover, the incorporation of the subsidiary's figures is not regarded as justifiable.

WHEN GROUP ACCOUNTS ARE NOT PREPARED.

The Act (Eighth Schedule, para. 15) provides that when group accounts are not submitted, there must be annexed to the balance sheet of the holding company a statement showing:

- (a) The reasons why subsidiaries are not dealt with in group accounts;
- (b) The net aggregate profit or loss of subsidiaries, so far as it concerns members of the holding company, for:
 - (1) the respective financial years of the subsidiaries ending with or during the holding company's financial year, and
 - (2) previous financial years of subsidiaries since they respectively became subsidiaries.

* See footnote in the account of Olympia Ltd., on page 378.

(Separate aggregate figures are required, where applicable, to indicate profits *dealt with* and *not dealt with*, respectively in the holding company's accounts).

The Council of the Institute, after obtaining opinion of Counsel and consulting the Board of Trade, suggested the following form of statement* to comply with this requirement:—

	<i>Profits in respect of financial years of subsidiaries ending in</i>		<i>other years</i>	<i>Total</i>
	1949			
	£		£	£
The net aggregate amount of the profits <i>less losses</i> (A) of the subsidiaries so far as it concerns the members of this company (B)—				
(i) dealt with in this company's accounts for the year 1949				
amounted (gross) to	9,090	—		9,090
less income-tax	4,090	—		4,090
	5,000		(C)	5,000
(ii) not dealt with in this company's accounts for the year 1949				
amounted, after charging taxation, to	10,000	20,000		30,000

(A) Where applicable.

(B) Where one or more than one subsidiary is not wholly-owned.

(C) "Other years" will normally be years of subsidiaries ending prior to the holding company's year 1949; but if an interim dividend were declared by a subsidiary out of its profits for a year ending within the holding company's year 1950, and taken up in the holding company's accounts for 1949, the amount of such interim dividend would be included in this column.

This interpretation may clarify what has been a difficult provision to construe and seems to give effect to the probable intention behind the requirements that, when a company does not submit group accounts, it shall furnish the information which would appear in those accounts, so far as relates to the current year's and accumulated profits (including revenue reserves) or losses of the group as a whole.

The foregoing information *not* dealt with in the holding company's accounts should be restricted to that which *concerns members of the company*. The proportion relating to minority interests in subsidiaries should accordingly be excluded.

It is emphasised that the above statement is required whenever group accounts are not submitted. Strange as it may

*Reproduced from "*The Companies Act, 1947*," a booklet published in May, 1948, by *The Institute of Chartered Accountants in England and Wales*.

seem, no exception is made for those companies which do not prepare group accounts *because they are wholly-owned subsidiaries*.

CONSISTENCY OF BALANCE SHEET DATES WITHIN THE GROUP.

Except where the directors are of opinion that there are good reasons against it, the financial year of the parent company and all the subsidiaries must coincide. In this connection, where it appears to the Board of Trade to be desirable that the financial year of any company in the group be extended so that the accounts of the group can be made up to a common date, the submission of accounts to a general meeting, the holding of an annual general meeting and the making of an annual return may be postponed from one calendar year to the next (section 153).

Where the financial year of a subsidiary does not coincide with that of the holding company, the group accounts must, unless the Board of Trade on the application or with the consent of the holding company's directors otherwise directs, deal with the subsidiaries' affairs for the year ended within the period covered by the group accounts (section 152). When group accounts are not submitted, there must be annexed to the balance sheet a statement showing why the directors consider that the subsidiaries' financial year should not end with that of the holding company and the dates to which the subsidiaries' accounts have been prepared or the earliest and latest of those dates (Eighth Schedule, para. 15). If in expressing opinions on these matters, directors make statements of fact which are inconsistent with the accounts, it would seem that auditors will be lacking in their duty if they do not draw attention to these in their report.

DEFINITIONS OF HOLDING AND SUBSIDIARY COMPANIES.

It is obviously important to determine whether or not the relationship which exists between two companies is that of holding company and subsidiary, or whether two companies are merely associated. The former relationship is of special legal significance and, when established, brings into operation portions of the law relating to companies which would not otherwise be relevant, i.e. the provisions referred to in this chapter.

The definitions of holding and subsidiary companies are now contained in section 154 of the Act. This section specifies *three conditions, any one of which* creates the relationship under notice. These three conditions are:—

1. *One company must be a member of the other AND control the composition of its board of directors.*

The former is then a holding company and the latter is its subsidiary. One share is, of course, sufficient to satisfy the first part of this condition. The second part is satisfied if the first company has power to appoint or remove the whole or a majority of the directors of the other company *without the consent or concurrence of any other party*. A company is deemed to have power to appoint a director where he cannot be appointed without its consent, or where his appointment follows necessarily from his directorship of the holding company, or where the directorship is held by the holding company or by another subsidiary of it.

It is not unusual for preference shares to carry voting rights only when the dividend is in arrear and it may not be realised that this factor, on happening, could in certain circumstances create the relationship of holding company and subsidiary between two companies. This would arise when one company held less than 50 per cent. of the ordinary shares of another company, but sufficient preference shares (limited as to dividend and also in a capital distribution) to give the former company a majority of the voting rights while the dividend was in arrears.

2. *One company must hold more than half in nominal value of the equity share capital of the other.*

It will be appreciated that a fifty per cent. equity holding is insufficient. To constitute the relationship of holding company and subsidiary the former must hold *more than one-half* of the equity share capital of the latter, *calculated on the basis of the nominal capital without regard to the amount paid-up*.

"Equity share capital" is defined by the section as "*issued share capital excluding any part thereof which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution.*"

Shares must be held by a company in its own right and not merely in a fiduciary capacity (e.g. shares held by a company in trust for an individual) in order to qualify for inclusion when

determining whether one company is the subsidiary of another, but shares held by another person as nominee for the company or any of its subsidiaries are treated as being held for this purpose.

Ordinary shares constitute equity capital except in those cases where their rights to participate in profits *and* in a capital distribution are limited in favour of another class (e.g. deferred shares), in which case the latter constitute the equity capital. Preference shares are normally excluded, but if participating preference shares have an *unlimited* participating right *either* to profits *or* in a capital distribution (which in practice would invariably be along with shares of another class), they would form part of the equity capital within this definition.

A company may acquire the status of subsidiary under this condition through the medium of another company. Thus, of "C" Company's equity capital, 30 per cent. is held by "A" Company and 21 per cent by "B" Company. If "B" Company at any time becomes a subsidiary of "A" Company this will automatically result in "C" becoming a subsidiary of "A" (provided, of course, that the shares are not held merely in a fiduciary capacity). The same would apply if the shares were held by a nominee for either "A" or "B" Companies.

In determining whether one company is a subsidiary of another, shares held by any person by virtue of the provisions of any debentures of the first-mentioned company, or of a trust deed for securing any issue of such debentures, must be disregarded. When a company's ordinary business includes the lending of money, shares in a company held as security in a normal business transaction are treated for this purpose as not being held by the company.

3. *Where the company is the subsidiary of the holding company's subsidiary.*

Thus, if "X" Company becomes the holding company of "Y" Company, it automatically acquires any subsidiaries of "Y" Company, e.g. "Z" Company—often termed a sub-subsidiary.

It will be seen therefore that a legally constituted group of companies under the Act may comprise grandchildren as well as children and even great-grandchildren and their issue indefinitely.

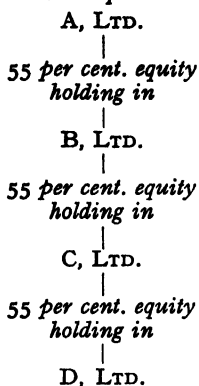
Perhaps it may be as well to reiterate that satisfaction of *any one* of the foregoing conditions is sufficient to create the relationship of holding company and subsidiary. It is usual in practice for No. 1 to apply also when No. 2 is applicable.

The alteration in the definition of a subsidiary company has resulted in certain cases of companies which were subsidiary companies within the meaning of section 127 of the 1929 Act, now ceasing to occupy that status under section 154 of the new Act. For example, a holding company might have held directly or indirectly more than fifty per cent. of the issued share capital of another company which, by the 1929 Act, was sufficient to constitute the latter a subsidiary, but unless the holding company's investment consists of *more than half in nominal value of the equity share capital*, this would not create the relationship of holding company and subsidiary company after 30th June, 1948. Again, the 1929 Act provided that entitlement to more than fifty per cent. of the voting power in a company constituted the latter a subsidiary. This does not now apply (although, of course, such voting power will normally carry with it control of the composition of the Board of Directors).

Conversely, a company may have held more than half in nominal value of the equity share capital in another company, but not until 1948 did the latter become a subsidiary, unless the shares held by the former amounted to more than half the aggregate issued capital or one of the other conditions was satisfied. Many instances also occurred on the coming into force of the Act of companies automatically acquiring holding company status over other companies because the latter were subsidiaries of existing subsidiaries.

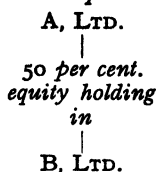
As already mentioned, a subsidiary need not be included in group accounts when this would be misleading or where the amounts are insignificant. The Act has therefore recognised that by drawing rather wide definitions of holding and subsidiary companies in section 154, there is need for some latitude in the requirements relating to the preparation of group accounts.

There is sometimes more logical reason to include in consolidation the accounts of a company which is not a subsidiary within the definition of section 154 than a company which is. This is illustrated by the three hypothetical cases shown in the diagrams which follow:—

Example 1

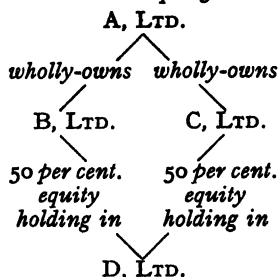
A, Ltd. has an interest of less than 17 per cent. in the equity of D, Ltd. (i.e. $\frac{55}{100} \times \frac{55}{100} \times \frac{55}{100}$).

D, Ltd. is a subsidiary of A, Ltd. (through C, Ltd. and B, Ltd.).

Example 2

A, Ltd. has an interest of 50 per cent. in the equity of D, Ltd.

B, Ltd. is NOT a subsidiary of A, Ltd.

Example 3

A, Ltd. has 100 per cent. interest in the equity of D, Ltd.

D, Ltd. is NOT strictly a subsidiary of A, Ltd. since it is not a subsidiary of B, Ltd. or C, Ltd. and although A, Ltd. controls the composition of the Board of D, Ltd., it is not a member of D, Ltd. (It could, of course, be argued that B, Ltd. and C, Ltd. are *nominees* of A, Ltd. for this purpose.)

It is assumed that no voting powers arise on any preference shares issued by the above companies.

CONSOLIDATED ACCOUNTS.

The preparation of consolidated profit and loss accounts and consolidated balance sheets—the most usual form in which group accounts are presented—is one of the most important developments in modern accounting and perhaps the most troublesome. The Act contained the *first* legislation on this subject.

It is therefore not surprising that the practical application of these legal requirements still gives rise to much thought and discussion on the part of accountants. Differences of opinion

remain on certain aspects of the procedures to be adopted in order to ensure that consolidated accounts give "*a true and fair view of the state of affairs and profit or loss of the company and the subsidiaries dealt with thereby as a whole*" as required by the Act (section 152). Comprehensive group accounts were, of course, prepared by some progressive companies prior to 1948, this being another example where legislation has been modelled on the best accounting practices which have preceded it.

The Act does not (perhaps fortunately !) say how this "true and fair view" shall be achieved and it is left to companies to give effect to the provisions according to the circumstances prevailing in each individual case. Directors of holding companies are, however, empowered to make any adjustments which they consider necessary in the preparation of consolidated accounts—which are required to combine the information contained in the separate balance sheets and profit and loss accounts of the holding company and of the subsidiaries included in the consolidation (Eighth Schedule, para. 17).

The vast majority of companies have left it to their auditors to devise their consolidated accounts in a form which best pictures the group financial position and most accurately computes the group profit or loss. The profession has not been slow to demonstrate its sense of responsibility in this matter and it is due mainly to the efforts of accountants that the spirit of the new legislation is being given effect to and is, on the whole, working satisfactorily.

Concurrent with this new responsibility, accountants have had the task of drastically revising the form of final accounts of companies generally in order to comply with the considerably more exacting requirements of the Act in regard to profit and loss accounts and balance sheets, as explained in other chapters.

Many of these problems are applicable also to consolidated accounts, but the latter have created a number of difficulties peculiar to the processes of consolidation and these are discussed in this chapter. In May, 1949, some notes were issued on this subject by the Taxation and Financial Relations Committee of the Institute of Chartered Accountants in England and Wales. The Council of the Institute refrained from expressing any opinion on the matters dealt with in the notes owing to the very short experience of the profession in the preparation

of consolidated accounts, but nevertheless acknowledged the valuable work of the Committee.

CONSOLIDATED BALANCE SHEETS.

A consolidated balance sheet must combine the information contained in the balance sheet of the holding company with the information contained in the balance sheets of the subsidiary companies, but with such adjustments as are necessary, e.g. the elimination of inter-company shareholdings and indebtedness (Eighth Schedule, para. 17). In preparing a consolidated balance sheet, the requirements of the Act relating to balance sheets generally must be observed (para. 18), unless sanction of the Board of Trade is obtained (section 152). The consolidated balance sheet should show the aggregate interest, if any, in the share capital and reserves (including the profit and loss account balances) of subsidiary companies belonging to shareholders other than the companies whose accounts are contained in the consolidated figures. Examples of consolidated balance sheets, illustrating the form to be adopted when a proportion of the share capital is owned by outside (i.e. "minority") shareholders are reproduced in Appendix B.

CONSOLIDATED PROFIT AND LOSS ACCOUNTS.

A consolidated profit and loss account must combine the information contained in the profit and loss account of the holding company with the information contained in the profit and loss accounts of subsidiary companies (para. 17) *after eliminating* inter-company transactions, including dividends paid by the subsidiary companies to the holding company. The form of consolidated profit and loss account must comply with the requirements of the Act for profit and loss accounts generally (para. 18), subject to any modification as may be approved by the Board of Trade in the light of any special circumstances appertaining in the case of an individual company (section 152).

When shares in subsidiary companies are held by interests outside the group, the net profit or loss shown in the consolidated profit and loss account should be apportioned in such a manner as to show the amount attributable to the interests of the holding company and that attributable to outside interests. Examples will be seen in Appendix B.

When the accounts in respect of a subsidiary are excluded from consolidation, it is provided that the holding company shall include in the consolidated balance sheet (and statements annexed thereto) information regarding such subsidiary which is required by the Act to be included in the balance sheet of a holding company and shall show in the consolidated profit and loss account the income from or provision made for losses of such subsidiary (Eighth Schedule, para 21). Investments in subsidiaries which are not consolidated will be seen in the balance sheets of Imperial Chemical Industries, Ltd., Gestetner, Ltd., and (in the corresponding figures only) Dunlop Rubber Co., Ltd., in Appendix B.

PROFIT AND LOSS ACCOUNT OF HOLDING COMPANY.

The profit and loss account of a holding company may be in the form of a consolidated profit and loss account dealing with all or any of its subsidiaries as well as the company, provided:

- (a) the requirements of the Act relating to consolidated profit and loss accounts are complied with, and
- (b) the account shows how much of the consolidated profit or loss for the period is dealt with in the accounts of the holding company (section 149).

It may be of interest to mention that the Millin Commission in South Africa, although endorsing most of the new company legislation in this country, has recommended that a company should not be relieved of the obligation to publish its own profit and loss account by reason of publishing a consolidated profit and loss account. It seems that an amendment to the 1948 Act on these lines might be an advantage here.

The accounts of Gestetner, Ltd., and Dunlop Rubber Co., Ltd., reproduced in Appendix B, are examples of cases where the holding company's profit and loss account is shown in addition to a consolidated profit and loss account. In the Dunlop accounts it will be seen that separate profit and loss accounts of the holding company *and* the subsidiaries as a whole are shown, in addition to a consolidated profit and loss account.

INTERVENTION OF THE BOARD OF TRADE.

The Board of Trade may, on the application or with the consent of a company's directors, alter the foregoing

requirements in regard to consolidated balance sheets and profit and loss accounts for *the purpose of adapting them to the circumstances of the company* (section 152). The exceptions from certain provisions of the Act relating to balance sheets and profit and loss accounts of banking, discount or assurance companies (and such other companies as the Board prescribes), apply also to consolidated accounts (Eighth Schedule, para. 26).

THE OBJECT AND LIMITATIONS OF CONSOLIDATED ACCOUNTS.

Section 151 provides that holding companies shall normally present group accounts in the form of a consolidated profit and loss account and consolidated balance sheet. The alternatives mentioned on pages 72 and 73 are available to meet special circumstances when, for the various reasons outlined, consolidated accounts are not practicable, suitable, or appropriate. In the vast majority of cases, however, holding companies have presented group accounts to shareholders in the form of consolidated accounts.

Several examples of consolidated accounts are reproduced among the published accounts in Appendix B.

The underlying object of consolidated accounts is, of course, to show in one profit and loss account and one balance sheet the results and financial state of affairs respectively of the holding company and its subsidiaries, as if the whole group were constituted as one company, operating through one or more branches.

This is a most satisfactory procedure from the viewpoint of shareholders of the holding company because, provided the interests (capital and revenue) in subsidiaries held by outside shareholders have been carefully segregated, the consolidated accounts do (or at all events should) reveal the results and financial position of that proportion of the group which belongs to them.

To outside shareholders of any of the subsidiaries, however, the consolidated accounts may appear to be of little more than academic interest, since the only information likely to be revealed to such investors is the general year-to-year progress and the financial position of the group as a whole, in which their interest is a slender one. Nevertheless, the progress of the company in which they have invested is largely wrapped up in the fortunes of the group.

Creditors, both of the holding company and the subsidiaries will normally have little interest in the consolidated accounts. While a group of companies is recognised by the Act, the attribute of legal entity is not conferred upon the group as such; it remains with *each separate company* within the group. Creditors can therefore look for satisfaction of their debts only to the assets belonging to the one company to which they have extended credit. It may be, of course, that a company will help a financially embarrassed subsidiary, but it is not bound to do so. A creditor is on safer ground if he assumes that the holding company will, as a matter of group financial policy, cut its losses, if necessary, by allowing an unsuccessful subsidiary to terminate its career in liquidation.

One disadvantage of consolidated accounts is that losses of some subsidiaries may be concealed and the drain on the profits of other companies in a group may not be appreciated.

INTER-COMPANY TRANSACTIONS.

It is, of course, a fundamental rule in the preparation of consolidated accounts that all transactions internal to the group, i.e. inter-company transactions, should be eliminated.

Dividends paid by subsidiaries to the holding company will normally appear *net* (i.e. after deduction of income tax) in the accounts of the subsidiaries but *gross* in the profit and loss account of the holding company. The adjustment which has been made in order to "gross-up" the amount in the books of the holding company needs to be reversed for consolidation purposes so that it will exactly match its counterpart in the subsidiary's accounts.

Sales of fixed assets by one company to another within the group may be ignored when preparing consolidated accounts, except that any profit element in the transactions needs to be eliminated by being written-back from group profit to the asset concerned. This applies equally when one company manufactures capital assets which are purchased by another company in the group for its own use.

When the balance sheet dates of all companies in the group do not coincide, considerable care is essential to detect transactions arising between one year-end date and another which, unless adjusted, will distort the group financial picture.

When shares in the holding company are held by subsidiaries, the *par value* of such internal holdings should be

deducted from issued capital in the group balance sheet. Any difference between the par value and the amount at which the investment stands in the subsidiaries' accounts should be transferred to capital reserve or goodwill. Dividends paid on any holding company's shares held by subsidiaries should be eliminated in the consolidation in the same manner as the more usual dividends in the opposite direction, i.e. from the subsidiary to the holding company.

It is important to ensure that any inter-company profit included in stock held at the date of consolidation (e.g. on stock sold by Subsidiary "A" to Subsidiary "B," but not yet disposed of by the latter) be adjusted by reducing both group profit and stock-in-trade by the amount of the internal profit.

ADJUSTMENTS ON ACQUISITION OF SUBSIDIARIES.

When a subsidiary is acquired, the excess of the total cost of shares in the subsidiary over the book or estimated value of attributable net assets (i.e. the proportion of assets less liabilities attributable to the shareholding acquired) will appear as *goodwill* in the consolidated balance sheet, and this should be suitably described. Conversely, when the attributable net assets exceed the purchase price paid, the difference will be shown in the consolidated balance sheet as a capital reserve. (Examples will be seen in the consolidated balance sheets of Morris Motors, Ltd., and Aerated Bread Co. Ltd., in Appendix B.) Where there are two or more subsidiaries the aggregate or the "net" of such differences will appear either as goodwill or as capital reserve, and the nature of the balance should be suitably described in the narrative, e.g. "*Goodwill, being excess of Aggregate Cost of Shares in Subsidiaries over value of Attributable Net Assets of Subsidiaries.*" (Examples will be seen in the balance sheets reproduced on pages 374 and 401).

Frequently the most difficult items to be dealt with in the essential process of eliminating internal balances arise out of the reconstruction of this figure of "Investment in Subsidiary Companies" which appears as a separate item in the balance sheet of the holding company, but which is replaced in the consolidated balance sheet by the assets and liabilities of the subsidiaries, adjusted as may be necessary. If the shares in a subsidiary have been acquired at par the procedure is straightforward, as the introduction of the assets and liabilities of the subsidiary will exactly replace the investment in the

subsidiary appearing in the holding company's balance sheet. But when shares in a subsidiary are acquired at a premium, the amount of the premium needs to be treated on the assets side. This can correctly be described as goodwill, as stated above, since the holding company has paid for the goodwill (i.e. the benefit of the connection, reputation or earning capacity) of the subsidiary.

Where, however, the premium has been paid in consideration of the fact that a re-valuation of the fixed assets of the subsidiary has disclosed a surplus, the assets appearing in the balance sheet of the subsidiary may be adjusted in the consolidated balance sheet in accordance with the new valuation. If, however, the premium was paid because of the existence of accumulated earnings or capital reserves standing in the subsidiary's books at the date of acquisition, the premium may be expunged against the appropriate part of such balances.

When control of a company is acquired for the purpose of taking over a competitive business, the shares being acquired at their "nuisance value," any price paid in excess of the value of net assets taken over may appropriately be shown as goodwill (as the prospective earning capacity of the group may justifiably be regarded as having been increased).

It has been suggested that companies should disclose in a note how the balance of goodwill arising from consolidations has been derived, e.g. by furnishing a schedule of the prices paid for shares together with such deductions as have been made for pre-acquisition profits of subsidiaries, for amounts devoted to writing-up subsidiaries' assets and for any profits appropriated by the holding company in reduction of goodwill, but the author has yet to see a case where this disclosure has been made.

If the shares in a subsidiary are purchased for *less* than their nominal value, the discount, as already stated, should be treated as a capital reserve. In such cases it often happens that "dead wood" appearing in the balance sheet of the subsidiary (e.g. preliminary expenses, share issue expenses, accumulated losses, etc.) can be set off as far as possible against the capital reserve.

PRE-ACQUISITION PROFITS AND LOSSES.

It will be appreciated that any capital reserve so created in the consolidated balance sheet will normally be represented

in part by revenue reserves in the balance sheets of the subsidiaries.

Undistributed profits in the books of subsidiaries automatically become *capitalised* in the foregoing process, thus giving effect to the Eighth Schedule 15 (5) which requires that pre-acquisition profits belonging to subsidiaries shall be treated by the holding company as capital profits.

If the date of acquisition falls within a subsidiary's accounting year, any reserves (including accumulated profit) appearing in the balance sheet immediately prior to acquisition should be increased for this purpose by any profit earned, less dividends paid, to the date the company becomes a subsidiary, or conversely, reduced by any loss incurred during that period. The sub-paragraph of the Eighth Schedule mentioned above, provides that if it is not practicable to apportion profits or losses as between pre-acquisition and post-acquisition periods with reasonable accuracy by reference to the facts, the apportionment may be made on a day-to-day basis. (The latter is the normal method adopted except in special circumstances, such as when a pronounced seasonal trade is carried on by the subsidiary).

There would appear to be no objection to dealing with the whole of the current year's profit earned by a subsidiary in the consolidated profit and loss account, provided a transfer of any pre-acquisition profit to either capital reserve or goodwill is specifically shown.

When an interest in a subsidiary is secured by instalments over a period, the proportion of pre-acquisition profits appropriate to the proportion of shareholding acquired is sometimes determined as applicable to each individual purchase. It is suggested, however, that *the date on which a company becomes a subsidiary* is the datum line for the purpose of measuring pre-acquisition profits, and this incidentally simplifies the adjustment.

Where the whole of a subsidiary's capital is not purchased by the holding company, the proportion of reserves or deficiencies appropriate to minority interests should be shown in the consolidation and accordingly excluded from pre-acquisition profits contained in capital reserve or goodwill.

It is often overlooked that when a company possesses revenue reserves at the date it becomes a subsidiary and subsequently incurs losses, which are written-off against the

reserves in its own accounts, the same procedure is not permissible in the group consolidation, since in the group accounts the reserves have been clothed with the attribute of capital and are not available for the purpose of setting-off revenue losses. Such losses must therefore be charged against group revenue, or if there is no group revenue they must be carried forward as a revenue deficit in the consolidated balance sheet.

Conversely, a debit balance on the profit and loss account of a subsidiary at the date of acquisition may be written-off against future profits in the accounts of the subsidiary, but such profits earned by the subsidiary can be brought into the group accounts as a revenue surplus.

It will be observed that the legal requirement in regard to pre-acquisition profits and losses of subsidiary companies brings the law into accord with the generally accepted accountancy practice (referred to on pages 198-199) of treating profits and losses prior to incorporation as capital.

Arising out of the statutory requirement that pre-acquisition profits must be treated as capital, an announcement has been published by the Share and Loan Department of the London Stock Exchange in connection with applications for quotations, specifying that the Department requires to be satisfied that, in arriving at any estimate for prospectus, etc., purposes, account has been taken by a holding company of the fact that any pre-acquisition profits will *not* be available for distribution.

TAXATION.

The controversy as to whether profit set aside for income tax and profits tax due after the balance sheet date is a reserve or a provision is discussed at some length on pages 140-143.

"Pre-acquisition profits" of a subsidiary, earmarked for this purpose, would, if regarded as a revenue, assume capital characteristics in the group accounts and would accordingly not be available to meet payments of tax on the subsidiary's profits earned prior to acquisition of the subsidiary by the parent company. The logical procedure would appear to be to include any such amounts as reserve for future taxation in the consolidated balance sheet, but whether this is strictly in accordance with the requirements of the Eighth Schedule, para. 15 (5) is debatable.

Another matter to be considered in connection with amounts set aside for taxation is the desirability for consistency among companies within a group. It may happen that some companies confine themselves to the legal obligation, while others reserve for taxation payable in future years on profits earned to the date of the balance sheet. In the interest of uniformity, adjustments are desirable so that the same basis may apply to all companies whose accounts are included in the consolidation.

MINORITY INTERESTS.

When a subsidiary is wholly-owned by the holding company, all amounts included in the accounts of that subsidiary relate to the group. When, however (as often happens), a portion of a subsidiary's capital is owned by outside shareholders, the proportion of the capital, reserves and undistributed profit attributable to outside or *minority interests* should be shown as such in the consolidated balance sheet, either as an aggregate figure or as separate items, preferably extended into one sub-total (see balance sheets of Imperial Chemical Industries, Ltd., Aerated Bread Co., Ltd., Gestetner, Ltd., Fisons, Ltd., and Dunlop Rubber Co., Ltd., in Appendix B). Similarly, the share of profit for the year under review applicable to minority interests must be shown separately in the consolidated profit and loss account (as shown in the profit and loss accounts of the same companies in Appendix B). In a straightforward case the figure for minority interests in the consolidated balance sheet will consist of the par value of shares held by outside shareholders in the subsidiaries, plus a proportionate part, if any, of the capital and revenue reserves of subsidiaries, and in the consolidated profit and loss account, the proportionate part of the profit or loss applicable to minority interests.

In some cases, however, there are special circumstances which may become highly complicated and involved. Preference dividends paid by a subsidiary to outside shareholders *out of profits earned prior to acquisition* may need to be charged against pre-acquisition profits which have been capitalised in either capital reserve or goodwill. Where any dividend is outstanding on cumulative preference shares, this contingent liability may be dealt with by way of a memorandum note on the consolidated accounts, or alternatively, the amount of

the arrears (less income tax as estimated) may be included with the "minority interests" item in the consolidated balance sheet.

Again, when "minority" shareholdings enjoy participating rights, contingent upon and varying with dividends paid on equity capital, it may be desirable to assess the probable future claim of outside preference shareholders upon revenue reserves and include this estimated sum in the amount shown as due to minority shareholders.

If losses appearing in the accounts of a subsidiary, as applicable to shares held by outside shareholders, exceed the par value of those shares, such excess should not be treated as attributable to minority interests, since the shareholders concerned cannot be called upon to defray such a deficiency. As the holding company is retaining its control despite losses being incurred, it must bear the burden of the excess deficiency.

These are typical problems which may arise on consolidation when computing the liability to outside shareholders at the date of the balance sheet.

ACCOUNTS INCLUDED IN CONSOLIDATION.

It would seem that it is not essential for the accounts of subsidiaries to be formally adopted in general meeting before consolidation.

Power is given to the Board of Trade by section 152 (2) to allow a holding company to deal with the accounts of a subsidiary up to a date other than the end of its financial year. Sanction may therefore be obtained to make up special accounts to a particular date and for a particular period for the purpose of consolidation.

COMPLIANCE WITH ACCOUNTING PROVISIONS OF THE ACT.

It is important to appreciate that consolidated accounts are required to comply, so far as applicable, with the requirements of the Act relating to accounts generally (section 152). The new statutory provisions relating to profit and loss accounts and balance sheets must therefore be observed in the preparation of consolidated accounts, which are accordingly required to give *a true and fair view of the state of affairs and profit or loss* of the companies included in the consolidation so far as concerns members of the holding company.

The only exceptions to the foregoing are that consolidated accounts need not reveal the aggregate amount of directors' emoluments, pensions or compensation for loss of office or loans to officers, all of which are required to be disclosed in the accounts of the separate companies (Eighth Schedule, para. 19). The Institute has suggested that the item of auditors' fees should similarly have been excluded, since some subsidiaries may disclose the figure in their profit and loss account and others may not (see page 211), resulting in the consolidated amount not being comprehensive for the group.

AUDITORS.

A person is not eligible for appointment as auditor of a company if he is, for any reason, disqualified for appointment as auditor of the company's subsidiary or holding company or a fellow-subsubsidiary of the same holding company (section 161).

The auditors' report must be expanded in the case of a holding company to cover any group accounts submitted. Auditors must state whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of the Act so as to give a true and fair view of the state of affairs and profit and loss of the company and its subsidiaries, *so far as concerns members of the holding company* (Ninth Schedule, para. 4).

It may happen that accounts which have not been audited are included in the consolidation (e.g. accounts of companies domiciled in a country where an audit is not compulsory). Auditors are well advised to draw attention to this in that portion of their report which relates to consolidated accounts.

When there are any qualifications in the auditors' reports upon accounts of subsidiary companies which are not embodied in Group Accounts, directors of the holding company are required to annex a statement to the annual accounts giving particulars of such qualifications, also any material notes contained in the accounts of the subsidiaries which, but for their inclusion, would properly have been the subject of qualifications by the auditors. If for any reason the directors are not able to do this, e.g. when a subsidiary is registered in a country where an audit is not compulsory, they are required to report accordingly (Eighth Schedule, para. 15).

The Act does not (as was advocated by the Cohen Committee) require auditors to report that, in their opinion, the reasons

given by the directors as to why the balance sheet of any subsidiary is not made up as at the date of the balance sheet of the holding company or why it is impracticable or misleading to include the accounts of any subsidiary in the consolidated accounts, are satisfactory.

BANK BALANCES.

When one or more companies in a group have overdrafts at the bank at the date of the consolidated balance sheet, these should *not* be set-off against the bank balances of the other companies. The aggregate overdrafts should appear separately among liabilities. The only exception to this rule is when overdraft and credit balances are at the same bank and the bank, by reason of some arrangement which has been made, would set-off the former against the latter.

UNIFORMITY IN ACCOUNTING PRINCIPLES.

Many of the accounting difficulties which arise in the process of consolidation are removed if uniformity in the application of accounting principles is observed throughout the group. In practice this usually takes some time to achieve, but the resultant advantages normally outweigh the work and the difficulties involved in altering accounting practices, some of which, admittedly, may have become deeply rooted.

Among the more important matters where consistency in accounting procedures will simplify the preparation of consolidated accounts are:—

1. Basis of arriving at the cost of fixed assets.
2. Method of providing for depreciation.
3. Treatment of taxation.
4. Method of stock valuation.

When uniform practices on such matters are not adopted, or are not possible, adjustments as necessary must be made (in accordance with the powers conferred by paragraph 17 of the Eighth Schedule). This is necessary so as to ensure that the consolidated profit and loss account and balance sheet *give a true and fair view* as required by section 152.

An example of such an adjustment which may be desirable is when fixed assets appear in the balance sheet of a subsidiary at cost *to the subsidiary*, but in the consolidated balance sheet they are shown *at a valuation* effected at the *date of acquisition*

of the subsidiary. If the relevant figures in the subsidiary's balance sheet can be so adjusted that they are in accord with the valuations shown in the consolidated balance sheet, several rather awkward adjustments arising each year will be avoided.

Again, as already mentioned in this chapter, the procedures adopted for reserving for future taxation on profits earned to the date of the balance sheet may not be consistent throughout the group. A wide diversity in practice is possible—ranging from making no reserve at all, to effecting elaborate calculations of the difference between the now appreciable initial allowances plus wear and tear for tax purposes and the normal annual depreciation provisions. Most companies are now finding that, owing to the effect of initial allowances, the liability for tax in a particular year is based on a profit which is materially less than the figure shown in the accounts. It will be appreciated that initial allowances merely *defer* tax—they do not reduce the ultimate tax to be paid. As stated in Chapter IX (where this matter is dealt with at some length) there is therefore a growing practice of creating a reserve (which may appropriately be styled “Reserve for Tax deferred by Initial Allowances”) so that consequential increases in the liability for taxation in future years over the amount which would have been payable if there were no initial allowances, may be charged against this reserve. (Examples will be seen in the balance sheets of Imperial Chemical Industries Ltd., and Fisons Ltd., in Appendix B.) Many companies employ the normal tax reserve for this purpose.

These are just two of the many divergencies in practice which are almost certain to arise at the start in all consolidations and which call for no small measure of accounting knowledge and skill if uniformity in accounting principles is to be secured.

The difficulties of achieving a reasonable measure of consistency within a group of companies are accentuated when the accountant responsible for the preparation of the consolidated accounts is not acting as accountant of *all* the companies involved.

FIXED ASSETS.

Reference has been made to the practice of valuing fixed assets belonging to subsidiaries for the purpose of the consolidated balance sheet on the basis of a valuation as at the

date the company became a subsidiary, since by this procedure, the cost *to the group* of such assets is shown. Although not always adopted, this practice has much to commend it. The alternative procedure of including fixed assets in the consolidated balance sheet at cost *to the subsidiary* results in the difference between such figures and the amounts regarded as *paid by the holding company* on acquisition appearing either in "good-will" or as "capital reserve." It is suggested that this does not so effectively achieve a "true and fair view" as the former method.

Fixed assets acquired by a subsidiary *after* acquisition appear, of course, at cost to the subsidiary in the consolidated balance sheet.

DEPRECIATION.

As already stated, when it is decided to show fixed assets in the consolidation at cost *to the holding company*, and such assets remain in the books of subsidiaries at cost, adjustments must be made when preparing the consolidated balance sheet. This gives rise to differences in the provisions for depreciation between the consolidated profit and loss account and the books of subsidiaries, since each will be based on different cost figures. Again, some companies in a group may adopt a renewals basis (at current price levels) in providing for replacement of assets, which will give rise to appreciable differences if depreciation on first cost is provided in the group accounts.

ADVANTAGES AND DISADVANTAGES OF HOLDING COMPANIES.

In conclusion, it may be useful to tabulate the principal advantages and disadvantages of holding companies:—

ADVANTAGES.

- (1) Uneconomic competition eliminated by acquiring direction of rival companies.
- (2) Overlapping costs (e.g. publicity, carriage, local representation, etc.), minimised by the parent company.
- (3) Raw materials and other essential supplies assured at economic price levels by obtaining a controlling interest in producing undertakings.

- (4) Markets safeguarded by obtaining control of distributive organisations.
- (5) Economies achieved in executive administration.
- (6) A convenient expedient for reconstruction (e.g. where an old company has been built up out of profits, and its actual value is greatly in excess of the issued capital, a new company may be formed to buy the shares of the old one at a figure commensurate with their actual values. This is one method of capitalising reserves).
- (7) The formation of holding companies creating large and influential combines is, to some extent, the corollary of powerful trade unions (labour disputes, wages and service agreements, etc., are more easily negotiated by large employers than by a number of independent concerns).
- (8) The individual identity of subsidiary companies can be retained, thereby avoiding loss in the value of goodwill.
- (9) Raising of capital and loans facilitated, large companies being able to obtain accommodation at better terms.
- (10) Capital resources may be transferred from one company to another to meet the demands of seasonal trade, special requirements, etc.
- (11) Shares of a large company command a wider market than those of a number of smaller companies.

DISADVANTAGES.

- (1) Loopholes for irregularities and fraudulent concealment exist by illegitimate transfers from the accounts of one company to those of another, although the provisions of the Act will go a considerable way in the reduction of such practices.
- (2) Excessive centralisation may result in responsibilities proving more onerous than the executive is capable, by ability and experience, of successfully accomplishing.
- (3) Large groups and combines tend to become "soulless," and fettered with undue "red-tape," thereby destroying individual initiative and enterprise. In the absence of efficient organisation, customers may lose a valuable sense of personal relationship.

- (4) Many people are apprehensive that the practice of combining the financial interests of companies has proceeded too far, large holding companies being financially interlocked with other large holding companies. Industrial power may accordingly be concentrated within a too-restricted circle, with possible economic dangers.

CHAPTER VII

GOODWILL

DEFINITIONS.

Few of the principles and considerations pertinent to other assets are applicable to goodwill, which is governed by a set of rules exclusive to itself. Although of an intangible nature, it is frequently the most valuable asset possessed, and its existence goes to the very core of the business. One of the earliest and most widely quoted definitions is that of Lord Eldon: "Goodwill is nothing more than the probability that the old customers will resort to the old place."

Other definitions which have been expressed are:—

"The benefit arising from connection and reputation."

"The attractive force which brings in custom."

"The only thing which distinguishes an old-established business from a new business at its first start."

"The capitalised value of an annuity in future super-profits."*

SOME IMPORTANT PRACTICAL CONSIDERATIONS.

Goodwill is usually brought into account on the incorporation of a company, the book figure arising out of the excess of purchase price of the business acquired over the agreed value of net assets (i.e. assets less liabilities).

The important considerations which appertain to goodwill can appropriately be illustrated by a concrete example:—

The XYZ. Co. Ltd. was incorporated on 1st July with a nominal capital of £30,000 to take over, as from that date, the business conducted under the sole-proprietorship of A. Trader. The purchase consideration was agreed at £25,000, to be satisfied as to £20,000 in £1 ordinary shares, and £5,000 in cash. The balance of 10,000 ordinary shares of £1 each were allotted for cash to other parties. The balance sheet of A. Trader on 30th June was as shown on the next page, all the liabilities and assets (including the bank balance) being taken over by the company:—

* The term *super-profits* is defined on pages 108 and 109.

GOODWILL

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BALANCE SHEET OF A. TRADER, 30TH JUNE, 19—.

	£		£
Capital Account—		Machinery	10,000
A. Trader	20,000	Furniture and Fittings ..	4,000
Sundry Creditors	9,000	Stock-in-Trade	7,000
		Sundry Debtors	5,000
		Cash at Bank	3,000
	<u>£29,000</u>		<u>£29,000</u>

After incorporation of the above figures, the books of XYZ. Co. Ltd. would be opened on 1st July with the following balances:—

	£		£
Authorised and Issued Capital:		Goodwill	5,000
30,000 Ordinary Shares		Machinery	10,000
of £1 each, fully-paid	30,000	Furniture and Fittings ..	4,000
Sundry Creditors	9,000	Stock-in-Trade	7,000
		Sundry Debtors	5,000
		Cash at Bank	8,000
	<u>£39,000</u>		<u>£39,000</u>

The figure for goodwill has been computed as follows:—

	£	£
Purchase consideration		25,000
Gross Assets taken over	29,000	
Less Liabilities taken over	9,000	
Net Assets	<u>20,000</u>	
Difference, being excess of purchase consideration over net assets taken over		<u>£5,000</u>

During the first five years of the company's existence profits as shown below were earned:—

	Profits.	Dividend.	
	£	Rate.	Amount.
	£		£
Year 1	200	Nil	
Year 2	185	Nil	
Year 3	540	Nil	
Year 4	6,200	12%	3,600
Year 5	8,250	12%	3,600

£2,500 was written off the goodwill account in the fourth year and a similar amount in the fifth year, the balance of profit being carried forward.

Over the five years under notice goodwill will accordingly appear in the balance sheets at the following amounts:—

				£
First year	..	..	..	5,000
Second year	..	..	..	5,000
Third year	..	..	..	5,000
Fourth year	..	..	..	2,500
Fifth year	..	..	..	Nil

The important principles emerging from this illustration will now be considered:

Firstly, no figure for goodwill appeared in the balance sheet of A. Trader, but immediately the business was taken over by the company, the rules of double entry demanded the creation of a book figure of £5,000. It may be assumed that the real value of the asset was entirely unaffected by the transfer of the business.

This exemplifies the important rule that goodwill is rarely, if ever, brought into the books until some change occurs in the management or constitution of a business.

Secondly, whatever the approximate intrinsic value of goodwill may have been at the date of transfer, the company, by reason of being willing to expend £25,000 for the business, agreed, in effect, to pay £5,000 for the benefit of A. Trader's connection, since the net assets were valued (and, we will assume, agreed) at £20,000. Expressing this from A. Trader's standpoint, he was able to obtain £5,000 for the goodwill he had built up.

This factor is present whenever a business is sold. The purchase consideration may be affected by external considerations, e.g. market demand for a particular type of business, trade conditions prevailing, negotiating ability of vendor, etc. Whatever may have influenced the price finally settled after negotiation, the purchaser will regard the price paid in excess of net tangible values acquired as being the cost of the advantage accruing from ownership of a business already established. Such benefit is clothed with the designation "goodwill."

The initial valuation of goodwill on incorporation of a company may accordingly be influenced by factors which have no direct bearing on profit earning capacity.

Even in trades where there is a generally accepted basis for valuing goodwill (e.g. number of sacks of flour used by

a baker, average daily gallonage sold by a retail milk distributor, etc.) such extraneous conditions as have been mentioned often affect the price paid. Moreover, although a standard formula for a particular type of business may be regarded as a broad yardstick of the earning capacity of a business, this needs to be reinforced by considerations of local conditions and circumstances peculiar to the individual business. Thus, a dairy situated in a densely populated district is likely to earn a higher ratio of net income per gallon of milk sold than a similar business operating in a scattered country district.

The third feature which will be observed in the simple illustration given, is that A. Trader assumed the role of shareholder in the new company, receiving as part of the purchase consideration, 20,000 out of the total number of 30,000 shares available. In addition to being vendor of the company, it is probable that he was also promoter of the company and, after incorporation, its chairman and managing director. This combination is not unusual.

In these circumstances the risk is always present that he may yield to the temptation to give full reign to his optimism in assessing the value of goodwill, resulting in a too generous estimation of its worth being included in the purchase price of the business.

This is one of the disadvantages of limited company constitution, inasmuch as a company may start its career loaded with a substantial figure for goodwill, which may not be justified by past results and become a permanent burden.

This evil is more apparent during cycles of prosperity and was all too common during the boom period in the twenties. During this era hardly a day passed without at least one addition to the ranks of companies carrying on luxury trades: gramophone records, cinemas, motor car gadgets, and the like. Many of these companies acquired businesses which had relatively grown up in a night, and paid grossly inflated prices for the invention acquired. When the depression period came along the heavy load of goodwill carried was one of the contributory causes of their downfall.

It has become generally recognised that, even under normal conditions, a more favourable price can be obtained for goodwill when a business is sold to a company than otherwise.

Finally, during the first three years of trading on the part of our imaginary XYZ Company Limited, profits were negligible, and as goodwill derives its value solely from the capacity of a business to attract profits, it would seem that the foregoing assumption as to its over-statement is a correct one. Despite this, the company made no attempt to reduce the balance sheet figure, since it possessed no profits out of which an allocation could be made for that purpose. (It will be explained later that amounts written off goodwill constitute an *appropriation* of, and not a charge against, the income of the year.)

In the fourth and fifth years the value of the company's connection increased substantially, yet it was in these years that the directors took advantage of consolidating the financial position by writing down the asset to such an extent that at the end of the fifth year it was completely written off. The residue of profits at the company's disposal, after payment of a dividend at the satisfactory rate of 12 per cent., could alternatively have been utilised in entirety for the building up of the reserve, but instead, as is not unusual, a portion of this surplus was allocated to the reduction of the goodwill account.

It is a frequent practice of companies to write down goodwill in periods of successful trading, but in years when profits are low, or non-existent, and goodwill consequently depreciating, they are powerless to make any adjustment to the book figure.

The conclusions drawn from the foregoing principles may conveniently be summarised in the following manner:—

- (1) Goodwill is rarely, if ever, brought into account until an appraisal of the business as a whole is demanded by the incidence of sale of the undertaking, or some change in its constitution.
- (2) The original valuation of goodwill, although based on some generally accepted standard, may be influenced by external factors which have no bearing on its true value when judged by the standard of future earning capacity.
- (3) The general nature of a company's constitution at incorporation lends itself to the inflation of goodwill.
- (4) Companies tend to write down goodwill when the true value is *increasing*, and leave the book figure undisturbed

when the real worth of the company's connection is contracting,

and, most important of all:—

- (5) The figure shown for goodwill in the balance sheet is at no time a criterion of its actual value to the company.

TREATMENT OF GOODWILL IN ACCOUNTS.

A realisation of these facts may prove disconcerting to the person unaccustomed to the niceties of accounting. If a balance sheet figure, by general acknowledgment, cannot be relied upon, he may well distrust the entire document and regard it as a statement of technical accountancy utility only.

An attempt will therefore be made to justify, on the grounds of expediency, the practice as it inevitably exists.

Superficial thought on the subject may lead to the conclusion that goodwill should be maintained in the balance sheet at its current intrinsic worth. The first difficulty that presents itself is in the estimation of this worth which, under the most favourable conditions, is a matter of conjecture. As will be asserted later, goodwill is only capable of valuation on an arbitrary basis. Furthermore, changes of executive would almost certainly result in differing valuations being attached to the asset, as no hard and fast rules can be established in this connection.

Even if it were possible to define with exactitude the value of goodwill on incorporation of a company, any variance, for balance sheet purposes, from the price paid for the asset, would be difficult to justify on the part of the promoters, who have committed the company to purchase it at that figure.

Once the company has embarked upon its career, the book figure must inevitably stand until such time as profits are adequate to permit of allocations to its reduction. Any theory which may be offered by the critic that goodwill should be depreciated when its value falls, by charges to the profit and loss account in the same manner as other assets, explodes when it is realised that in a year when a meagre net profit occurs, this diminutive figure would be further reduced, or converted into a loss, by any debit thereby created. Again, when a company incurs a loss, such deficiency would be increased by the amount written off goodwill.

Conversely, in prosperous years, goodwill would apparently require writing up, with a consequent credit to revenue,

resulting in the already satisfactory figure of net profit being augmented, and dividends possibly increased without justification. The outcome of this chaotic situation is that every fluctuation in profits would be accentuated, whereas prudent company finance dictates that dividends at a comparatively steady rate is the preferable objective.

It would seem from the foregoing, that goodwill should be read in the negative, i.e. the greater the prominence in the balance sheet, the lower its real value, and vice versa. Although this is not a rule for universal application, the paradox is sufficiently common to warrant permanent retention in the minds of those called upon to assess the financial position of companies by reference to balance sheets.

The balance sheets of Marks & Spencer, Ltd., Morris Motors, Ltd., and Gestetner, Ltd., on pages 351, 371 and 380 respectively, constitute excellent illustrations of successful companies which have utilised profits to write-down goodwill. In the first case it will be noticed that no figure appears in respect of this asset despite the fact that, in the year in question, £6,082,264 net trading profit was earned on an issued capital of £3,562,557, i.e. 170 per cent., before charging taxation.

A similar position, presented more conspicuously, exists in the Morris Motors, Ltd., accounts on pages 351 and 353. The writing-down of goodwill, patent rights and trade marks is prominently displayed by including these assets at the nominal figure of £1. Net profit earned by this company and its subsidiaries during the year amounted to over 126 per cent. of the capital issued.

Another example of the practice of writing-down goodwill to the nominal value of £1 will be seen in the balance sheet of Gestetner, Ltd., on page 380.

It will be observed also that, in all these balance sheets, substantial reserves are shown.

WRITING-DOWN GOODWILL AND CREATION OF RESERVES.

The question sometimes arises when a company is in the enviable position of having surplus profits at its disposal after capital has been adequately remunerated: "Shall this revenue fund be utilised to write-down goodwill or to create a reserve?"

The former alternative is normally preferable; the building-up of a reserve being subsequently effected after goodwill

has been reduced or eliminated. This commendable inclination to reduce goodwill in a company's balance sheet has the following weighty arguments to support it:—

- (1) Possible losses in the future are prudently anticipated. Such deficiencies automatically give rise to depreciation of goodwill at a time when nothing can be done in the matter of reducing the book value.
- (2) Goodwill is normally disposable only when the business as a whole is sold. Apart from nationalisation and the absorption of a company in a group of related enterprises, this eventuality is highly improbable except in the event of financial crisis, when the asset would have little or no value.

It is sometimes said that enhanced financial stability can be as effectively achieved by transfers to reserve as by allocations to the credit of goodwill account. The application of this theory results in a corresponding accretion to the reserve account, compensated by the retention of goodwill on the opposite side of the balance sheet.

Although this compensation would appear to reduce the position to equality, it is inevitable that the reserve will suffer reduction if losses accumulate in the future, since provision for "a rainy day" is the primary object of this fund.

Allocations to the reduction of goodwill may accordingly be regarded as more permanent contributions to financial stability than transfers to reserve.

Nevertheless the case of *Stapley v. Read Bros., Ltd.* (1924), is of particular interest:—

Goodwill stood originally at £140,000 and was subsequently written-down out of profits over a period of years to £51,000. A reserve of £61,000 was also created out of profits. The balance of goodwill was written-off against this reserve, thus reducing the latter to £10,000. By the year 1920 the reserve had been increased to £25,000 and a further £15,000 was transferred thereto from the balance of the current profit and loss account, making the balance £40,000. This balance of £40,000 was then distributed in the form of fully paid shares by way of a capital bonus.

The company then experienced a period of bad trade, and at the close of the year 1922 there was a debit balance of

£20,504 16s. 6d. on the profit and loss account. A profit of approximately £13,000 accrued in the year 1923 out of which the directors proposed to pay three years' arrears of preference dividend. They also proposed to write off the accumulated loss of £20,504 16s. 6d. by restoring goodwill in the books at £40,000 and crediting reserve account with this amount.

An injunction was sought to restrain the company (a) from distributing a dividend until the accumulated loss had been discharged; (b) distributing as dividend, profits originally applied to writing down the book value of assets and subsequently written back; (c) dealing with any unrealised profit resulting from an estimated appreciation in the value of capital assets.

The plaintiff did not contend that the goodwill was over-valued at £40,000 but that profits utilised to write down the book value of assets could not subsequently be written-back, and treated as available for distribution.

Mr. Justice Russell in refusing the injunction, expressed the view that the profit and loss account need not be treated as a continuous account in such a manner that no dividend can be declared out of one year's profits until any debit to profit and loss in respect of prior years is made good. If £40,000 had been carried to reserve, it could have been subsequently distributed as dividend. It made no difference that the company, instead of carrying the sum to reserve, had utilised it to write-down goodwill. The shareholders had approved the directors' previous reports and proposals, but they had not bound themselves to give up their claims to the profits that had been carried to reserve and employed to write off goodwill. In brief, those profits had *not* been permanently capitalised.

VALUATION OF GOODWILL ON SALE.

Sufficient has been stated to indicate that the price paid by a company for goodwill is influenced by varied and extraneous circumstances, but it may be useful to include, within wide limits, a formula for application when arbitrarily assessing the value of the asset for purposes of purchase. This can be expressed mathematically as:—

$a \times \text{average profits earned by the business for the last } b \text{ years.}$

The symbol "*b*" may represent from two to five years, depending upon the nature of the business carried on, and the extent of fluctuations in revenue other than those of a seasonal character. The period taken should be sufficiently extensive to constitute a true criterion of the net profits level, in order to substantiate an estimate of future revenue.

Two years may be adequate in the case of an established business selling household necessities, whose turnover is reasonably constant. In contrast to this, an entertainment concern, the annual profits of which may vary with the spending capacity of the public, weather conditions, etc., thus fluctuating from year to year, might render a period of four or five years necessary, if a reliable average is to be adopted.

One to four may be employed for the symbol "*a*," the nature of the connection to be acquired, and the manner in which the goodwill has been derived, being the main tests for this purpose.

If past profits are shown to have been on an increasing scale, goodwill may generally be valued more liberally.

HOW GOODWILL ARISES.

It is therefore necessary to determine the general nature of goodwill and the expedients by which the asset has been created in the past. The latter may be classified in the following manner:—

- (1) *Personality*, e.g. a doctor, dentist, solicitor, etc. Personality in this connection may embrace personal skill, general education, bearing, tact and manner.
- (2) *Locality*, e.g. a retail store on a prominent site, pre-eminently suitable for that class of trade, or a cinema located in the town's central square, etc.
- (3) *Advertising*. The trade-name adopted for products, e.g. patent medicines, beef extracts, beers and stouts, etc., may become household words by reason of prolonged and intensive publicity of an effective character.
- (4) *Reputation*, e.g. may arise from a well recognised standard of high quality, consistently maintained, like that of a well-known motor car manufacturing company whose name has now almost become an adjective in general use, to denote the best quality of any product. Reputation may also have been established as the result

of reliable conscientious service, and efficient organisation which has become widely accepted.

- (5) *Period of Establishment.* In some cases a business which has been established for centuries so consolidates its connection as to make it almost unassailable.
- (6) *Monopoly*, e.g., by patented invention, merger of competitive interests, sole rights, etc.

Goodwill tends to lose its value on sale in a reducing degree reading from No. (1) to No. (6). For example, an appreciable portion of the value of a personal connection may be lost on transfer to another party. At the other extreme, goodwill existing by virtue of monopoly, is probably the most impregnable of all types, despite the economic criticism which may be levelled against it.

Moreover the value of a personal connection acquired is much more of a diminishing asset. It may be maintained for a time by the impetus of the old connection, but needs to be reinforced by an at least equal confidence in the new proprietor of the business.

“SUPER-PROFITS.”

One of the definitions of goodwill given at the opening of this chapter was “the capitalised value of an annuity in future super-profits.” By the expression “super-profits” is often inferred the return forthcoming on capital invested in excess of the prevailing rate obtainable on gilt-edged investments, but it might be more correctly defined as the excess of the income received over what might be regarded by the market as being adequate for the risks of the particular undertaking. Profits earned above the gilt-edged level compensate proprietors for embarking their funds in commercial enterprise, with its attendant risks, in contrast to the security afforded by investment in the more serene waters of “safety-first” securities.

It may be rightly asserted, therefore, that average profits for the purpose of goodwill valuation should exclude the first three to five per cent. on capital, the exact rate depending on prevailing conditions at the time of assessment.

Statements of profits earned, without reference to capital subscribed, may prove misleading. A typical example may be cited: One prominent British company made a profit of £3,234,317 in a recent year, but this amount was inadequate

to meet its preference dividends in full, so heavily was the company capitalised. By deducting a modest three per cent. of the issued capital in this case, the entire profit for the year would be absorbed.

It will be appreciated from this illustration that a substantial figure of profit earned does not, of necessity, establish the existence of "super-profits."

If effect is given to this element of "super-profits" the foregoing formula will be amended to:—

$a \times (\text{average profits for past } b \text{ years} - 3 \text{ per cent. to } 5 \text{ per cent. of issued capital}).$

The element of diminishing return on the transfer of a personal connection, as referred to on the previous page, may need to be taken into consideration in any mathematical assessment of goodwill.

GOODWILL AS SECURITY FOR A LOAN.

Goodwill suffers a very real disability when compared with tangible assets inasmuch as it affords no security for loans. Similarly, it is incapable of being charged by way of specific mortgage, although it may be included in a floating charge of the assets as a whole. In such circumstances the trustee, in the event of the charge crystallising, could utilise the company's connection in carrying on the business for the benefit of the creditors generally.

When assimilating the contents of a balance sheet from the standpoint of a prospective loan creditor, therefore, the goodwill figure, if any, should be entirely discounted.

GENERAL PRINCIPLES SUMMARISED.

At the risk of repetition, the somewhat complex principles which govern the asset may conveniently be summarised in the following form:—

- (1) The balance sheet figure for goodwill does not depend upon estimated current value, but is the outcome of what has been done in the past by way of expenditure on acquiring advantages coming within its category, less allocations of profit to its reduction.
- (2) Fluctuations in the balance sheet figure should not be allowed to affect current profits.

- (3) There is no legal obligation to reduce the cost price of goodwill unless the Articles direct otherwise. (*Wilmer v. McNamara & Co. Ltd.* [1895], see page 201.)
- (4) In the absence of some special provision in a company's articles it is unnecessary to make good depreciation of goodwill in ascertaining the amount of profit available for dividend.
- (5) Auditors cannot object to the value of goodwill provided items which are clearly chargeable wholly to current profits, are not debited thereto.
- (6) Amounts written off goodwill are appropriations of profits and not charges against current revenue.
- (7) Goodwill is not a banker's security.

LEGAL REQUIREMENTS.

From the provisions of paragraph 8 of the Eighth Schedule, it will be seen that such amount of goodwill as has not been written off must, whenever ascertainable, appear in every balance sheet issued by the company. In addition to this provision, the Third, Fourth and Fifth Schedules to the Act stipulate that every statement in lieu of prospectus and prospectus which is issued must specify the amount, if any, payable for goodwill.

Paragraph 5 of the Eighth Schedule provides that goodwill, patents or trade marks shall NOT be subject to the requirements of that paragraph relating to the method of arriving at the amount of fixed assets (i.e. at cost or at a valuation, less depreciation provided to date). These three assets need not be shown otherwise than as a single item (para. 8). Where only part of the goodwill is ascertainable from the books, that part must be shown in the balance sheet (para. 8).

Any charge made on goodwill to secure a debt must be registered within twenty-one days after its creation (section 95).

CHAPTER VIII

CAPITAL

DEFINITIONS OF CAPITAL TERMS.

The question reproduced below was set at a professional examination:—

The following terms are used to define Capital: authorised, borrowed, circulating, fixed, floating*, issued, liquid, nominal, paid-up, permanent, subscribed, working.

Group together those having similar meanings, and give a brief note explaining each group.

The diversity of meanings attaching to the term capital is well illustrated by this question, which should be read in conjunction with the under-noted definitions:—

Authorised.
Nominal.

These terms are synonymous, and indicate the total amount of capital which a company is authorised to issue. This figure is stated in the Memorandum of Association, and is incapable of *decrease* except with the consent of Court. It may be increased at any time as explained later in this chapter.

The authorised capital is subject to an *ad valorem* capital duty of 10s. per cent., which applies to all increases. The expression REGISTERED CAPITAL is an alternative designation.

Issued.
Subscribed.

That portion of the nominal capital which has been issued to shareholders, either for cash or other consideration.

Paid-up.

The total amount credited as paid-up on issued capital.

(NOTE.—The term CALLED-UP CAPITAL is used to denote that portion of issued capital which has been called up by the company. Thus, if 15s. per share is called-up on 1,000 shares of £1 each, the issued and subscribed capital is £1,000, called-up capital £750, and if £25 remains unpaid by a member, the paid-up capital is £725.)

Borrowed.

This includes all long-dated and permanent loans (e.g. debentures raised to finance the undertaking).

* The term "*current*" is now used instead of "*floating*."

Fixed.* The expression fixed capital is analogous to fixed assets, denoting the employment of capital in permanent assets. Similarly, the expression **WASTING CAPITAL** is used to indicate capital resources expended in wasting assets.

Permanent.* Corresponds with fixed capital, except that it might apply also to that subscribed or borrowed capital repayable only in the event of liquidation.

Circulating.* These terms denote current assets less current liabilities.

Floating.*

Working.*

Liquid.* Cash and easily realisable assets (e.g. bills receivable).

* These expressions refer to the representation of capital on the assets side of the balance sheet, and not to capital itself. Thus, issued or borrowed capital may be expended in both fixed and current assets. This is illustrated in the following skeleton balance sheet:—

	£		£
Authorised Capital:		Goodwill	1,000
5,000 Ordinary Shares		(Value estimated at	
of £1 each	5,000	£200.)	
		Fixed Assets	2,500
Issued Capital:		(Value estimated at	
4,000 Ordinary Shares		£2,000.)	
of £1 each	4,000	Current Assets:	£
Less Call in Arrear ..	100	Stock	900
		Debtors	200
	3,900	Cash	400
Profit and Loss Account	400		
500 5% Debentures of			1,500
£1 each	500		
Sundry Liabilities ..	200		
	£5,000		£5,000

The under-stated amounts may be attached to the various capital terms already mentioned:—

	£
Authorised Capital	5,000
Issued Capital	4,000
Called-up Capital	4,000
Paid-up Capital	3,900
Borrowed Capital	500
Fixed Capital—Book figure	3,500
Value	2,200
Circulating Capital	1,300
(i.e. Current Assets, £1,500, less	
Current Liabilities, £200.)	
Liquid Capital	400

BALANCE SHEET REQUIREMENTS.

Paragraph 2 of the Eighth Schedule provides that the balance sheet of a company shall contain a summary of the

authorised share capital and of the issued share capital. The extract below illustrates the usual form of displaying capital on the liabilities side of the balance sheet:—

Registered Capital.

	£	£
50,000 6% Preference Shares of £1 each ..	50,000	
200,000 Ordinary Shares of 2s. each	20,000	
80,000 Deferred Shares of 6d. each	2,000	
	£72,000	

Issued and Paid-up Capital.

50,000 6% Preference Shares of £1 each, 15s. paid	37,500	
100,000 Ordinary Shares of 2s. each, fully-paid ..	10,000	
80,000 Deferred Shares of 6d. each, fully-paid ..	2,000	
	49,500	
Less Calls in Arrear	42	
		49,458
Calls Received in Advance		1,000

The details given, showing how the registered capital is made up, are included in the balance sheet as a note only; these figures do not appear in the books of account, hence the alternative expression "nominal capital."

In the above illustration calls in advance have not been embodied in paid-up capital as such amounts do not represent share capital until the due date(s) of the calls.

SHARES AND STOCKS.

The capital of a company is divided, either into units of equal value, termed shares, or cut into slices of irregular monetary dimensions in the form of stock. Capital may not be issued in the form of stock in the first instance.

Shares have hitherto been identified without exception by consecutive numbers, and opposition to this practice has emanated from certain quarters for some considerable time. The Stock Exchange has always favoured retention of the practice, and opposition came mainly from those upon whose shoulders the registration of transfers falls. The contention has been repeatedly submitted on their behalf that the volume of work involved in dealing with shares separately numbered is not justified by the safeguards afforded.

At a late stage during the passage of the 1947 Companies Bill through the House of Commons (July, 1947) an amendment was put down and accepted by the Government for the *abolition*

of the distinctive numbering of shares where all the issued shares in a company or all the issued shares therein *of a class* are fully paid up and rank *pari passu* for all purposes. This exemption came into operation on 1st December, 1947, and is contained in section 74 of the 1948 Act.

Prior to the Act several prominent companies converted their shares into stock to eliminate the necessity for consecutive numbering, and the clerical work thereby involved.

If the new exemption is taken advantage of and the shares are quoted on the Stock Exchange, a fresh quotation must be applied for. The application must be under the common seal of the company and be impressed with a ten shilling stamp. The company is required to undertake that the shares are and will remain identical in all respects (i.e. as to nominal value, amount called up, rights as to unrestricted transfer and attendance and voting at meetings and amount payable per share at the next ensuing dividend distribution). It must also undertake to advise the Stock Exchange before taking any action to reinstate the distinguishing numbers of the shares in question or to consolidate or sub-divide the shares.

Each share constitutes a unit of share capital of the same value, and carrying the same rights as every other unit of the same class of shares. Stock, by distinction, may represent any denomination of issued capital, although it is usual for the Articles to provide that stock shall be transferable in minimum multiples of £1. It is not numbered, and the rights attaching to it by way of dividends, voting powers, and repayment are proportionate to the nominal value. Shares may or may not be fully paid, but stock must always be paid up. In all other respects shares and stock are alike.

It was held in the case *Re Boys; Westminster Bank, Ltd. v. Boys* (1950) that the expression "shares of a public company" includes stock of such a company.

VARIOUS CLASSES OF SHARES.

The capital of a company may be divided into shares of one class only, known as ordinary shares. Each share is then entitled to a proportionate part of profits and capital, and possesses voting rights applicable to every other share. Many companies, however, issue shares of two or more classes, each class having different rights as to capital, dividends, and perhaps voting powers.

The many types of shares (or stocks) available are described below. It should be mentioned, however, that, except in the case of some large undertakings, it is not customary for companies to issue more than two or three different classes:

(1) *Preference shares* are those having a prior right to dividends, i.e. dividends on other classes are deferred until the fixed rate is paid on the preference shares. They are invariably labelled with the preferential dividend rate to which they are entitled, e.g. "Five per cent. Preference Shares." Unless issued subject to contrary conditions, these shares have no preferential right to return of capital, that is to say, they rank, on winding-up, equally with other classes in this respect. Preference shares are, however, entitled to their proportionate share of any surplus on winding-up, after arrears of dividend, if any, have been met, and all capital repaid.

The Scottish Court of Session held in *Liquidators of Williamson Buchanan Steamers, Ltd.* (1936) that in a winding-up, all shareholders were entitled to share equally in any surplus assets, unless that right had been expressly or by clear implication taken away. In this decision the Scottish Court followed the decision of the English Court of Appeal in *re William Metcalfe & Sons, Ltd.* (1933).

The foregoing expresses what was the legal position, and it has therefore been customary, in practice, for companies to issue preference shares subject to a provision which entitles them, on liquidation, to priority as to repayment of capital and arrears of dividend up to the date of winding-up, over other classes, but to no further right to participate in profits or assets.

The following, extracted from a prospectus issued by Mentmore Manufacturing Co., Limited, is typical of such a clause:—

The Cumulative Preference Shares for the time being issued confer the right to receive a fixed cumulative preferential dividend at the rate of 6 per cent. per annum upon the amounts for the time being paid up or credited as paid up thereon, and to receive in a winding-up the capital paid up or credited as paid up thereon, together with any arrears of the said fixed cumulative preferential dividend whether earned or declared or not up to the commencement of the winding-up before any repayment of capital to the holders of the ordinary shares, but to no further right to participate in profits or assets.

This clause may be taken as representative of the provisions under which most preference shares are issued, thus clearly refuting their implied right to participate in surplus profits and assets on winding-up.

During recent years a change of law has been observed, there now being a presumption that preference shareholders are to receive nothing in excess of paid-up capital out of surplus assets, even though their rights to further participation on repayment are not expressly taken away by the articles and provisions of issue.

In the three cases of *Fife Coal Co. v. Armistron Coal Co.* (1948), *Prudential Assurance Co., Ltd. v. Chatterly Whitfield Collieries, Ltd.* (1949) and *Scottish Insurance Corporation v. Wilsons and Clyde Coal Co., Ltd.* (1949)—all cases consequent upon coal nationalisation—it was held that the preference shareholders were not entitled to share in surplus assets. Again in *Isle of Thanet Electricity Supply Co.* (1950) it was held on appeal that preference shareholders had no such right.

Where the articles specifically determine the rights of preference shareholders, the matter is not, of course, in doubt.

Unless the provisions of issue specify to the contrary, preference dividends must be paid *less tax*; the declaration of *free of tax* dividends would deprive ordinary shareholders of profits to which they are entitled.

The existence of profits adequate to pay the fixed dividends does not, of itself, give preference shareholders a claim to such dividend. If, in the directors' discretion, it would seem that allocations to reserve, or other purposes, are in the best interests of the company, they are justified in passing the preference dividend, or recommending its payment in part only (see *Bond v. Barrow Haematite Steel Co.* [1902] at page 194). But directors must act in the interests of the company as a whole; any attempt to defeat the claims of preference shareholders by this means would be nullified if the members concerned obtained an injunction restraining them from disposing of profits in the proposed manner.

Preference dividends may be paid in a year when a loss has been incurred, provided undivided profits carried forward from previous years are adequate to meet the payment. The words of Mr. Justice Clauson in the case of *Drown v. Gaumont British Picture Corporation, Ltd.* (1937), (pages 194-195), are of particular interest in the unusual circumstances present in that case.

The more recent case of *Buenos Ayres Great Southern Railway v. Preston and Another* (1947) should also be referred to (see page 195).

(2) *Cumulative Preference Shares.* If the full preferential dividend is not paid on these shares, they possess the right to receive arrears in future years in priority to dividends on those classes of capital ranking behind them.

It should be noted that, in the absence of provisions to the contrary in the Articles, all preference shares are deemed to be cumulative as to dividend. Non-cumulative preference shares are therefore always stated to be non-cumulative in the Articles and prospectus, if any.

It behoves the prospective investor in ordinary shares to ascertain, before purchasing, whether there are any arrears of dividend on cumulative preference shares. The market price of ordinary shares will be materially influenced by the existence of any arrears of dividend on preference capital, and what may appear to be an attractive quotation will be substantially discounted when the true state of affairs is known.

Paragraph 11 of the Eighth Schedule requires that the amount of any arrears of fixed cumulative dividends and the period for which the dividends are in arrear shall be disclosed by way of note or in a statement or report annexed to the balance sheet.

(3) *Participating Preference Shares* are entitled to a non-cumulative preferential dividend at a fixed rate, plus a right to participate further in profits, either along with, or after payment of dividends on other classes of shares. Multifarious arrangements whereby participating preference shares can be possessed of such powers are adopted, and the two reproduced on this and the next page are specimens illustrating the diversity of participating rights attachable to such shares. The first, that of Universal Greyhound Totalisators, Ltd., is an instance where exceptionally attractive profit sharing rights are given to the preference shares. The second is taken from the prospectus of Sound City (Films), Ltd. and, as is more usual, imposes a limit to the rate of dividend payable to the preference shareholders:—

- (a) The profits of the Company from time to time determined to be distributed by way of dividend are applicable (first) in payment of a fixed non-cumulative preferential dividend at the rate of 10 per cent. per annum on the amounts for the time being paid or credited as paid on the Participating Preference Shares, (secondly) in payment of a fixed non-cumulative dividend at the rate of 10 per cent. per annum on the amounts for the time being paid or credited as paid on the Ordinary Shares,

and, subject thereto, the balance of the said profits is applicable as to 50 per cent. thereof to the payment of a further dividend to the holders of the Participating Preference Shares and as to the remaining 50 per cent. thereof to the payment of a further dividend to the holders of the Ordinary Shares respectively, in proportion to the amounts for the time being paid or credited as paid on the Participating Preference and Ordinary Shares held by them respectively.

- (b) The profits which the Company may determine to distribute in respect of any financial period shall be applied first, in payment of a cumulative preferential dividend at the rate of 6 per cent. per annum on the amounts paid or credited as paid up on the Preference Shares; secondly, in payment of a non-cumulative dividend at the rate of 6 per cent. per annum on the amounts paid or credited as paid up on the Ordinary Shares; thirdly, of any surplus one-half shall be applied in payment of a further non-cumulative dividend at the rate of 9 per cent. per annum on the amounts paid or credited as paid up on the Preference Shares; and fourthly, the remainder of such one-half together with the other one-half of the surplus shall be distributed rateably among the holders of Ordinary Shares according to the amount paid or credited as paid up thereon.

(4) *Cumulative Participating Preference Shares.* This somewhat ponderous title is applied to those shares which combine the characteristics of cumulative and participating preference shares. The fixed dividend is accordingly cumulative, and the shares are entitled to some further participation in profits, as illustrated in the second extract above.

(5) *Redeemable Preference Shares* are a comparatively new type for other than statutory undertakings, first introduced with the passing of the Companies Act, 1929. Hitherto redeemable capital was regarded with disfavour as being an arrangement whereby capital would ultimately have to be reduced under the provisions of issue.

Safeguards were accordingly embodied in that statute (and have been re-enacted in the 1948 Act) to prevent capital raised in this form from being subsequently written down without sanction of the Court. The provisions of section 58 may be summarised as follow:—

- (1) An issue of redeemable preference shares must be authorised by the articles.
- (2) Redeemable preference shares are capable of redemption only when fully paid.

- (3) The redemption must be provided:
 - (a) out of profits available for dividends, *or*
 - (b) out of the proceeds of a new issue of shares for that purpose.
- (4) When alternative 3 (a) is adopted, a sum equal to the nominal amount redeemed must be transferred to a fund to be called the CAPITAL REDEMPTION RESERVE FUND.
- (5) Any premium on redemption must be provided for out of either:—
 - (a) profits, *or*
 - (b) any share premium account in existence.
- (6) The capital redemption reserve fund is capable of reduction only in like manner to the reduction of share capital (i.e. with the consent of Court).
- (7) The capital redemption reserve fund may be utilised for the issue of fully-paid bonus shares (subject to the current regulations as set out on page 251).

The Eighth Schedule (para. 2) provides that there must be specified in the balance sheet "*any part of the issued capital that consists of redeemable preference shares, and the earliest date (the 1929 Act stipulated the "latest date") "on which the company has power to redeem those shares."*

Section 58 specifies that the amount to be transferred to the Capital Redemption Reserve Fund must be *a sum equal to the nominal amount of the shares redeemed* and, to enable this to be done, the requirement of the 1929 Act that any premium on redemption is to be provided out of profits when a new issue is made for the purpose is extended to all redemptions.

It should be particularly noticed that when redemption is effected out of profits which would otherwise be available for dividends, an amount corresponding to the *nominal* value of the shares redeemed must be credited to a Capital Redemption Reserve Fund. The title of this account is specified in the Act, a provision almost without parallel in company legislation. Furthermore, the employment of the fund is rigorously restricted: not only is it incapable of use for revenue requirements, but it would be illegal to utilise any portion of it for normal capital purposes, such as writing off share and debenture discounts,

goodwill, etc. The Act of 1929 authorised (subject to the provisions of the relevant section) the employment of the capital redemption reserve fund for the purposes of an issue of bonus shares (by the Act of 1948 this may be done whether new shares are issued for the purpose of redemption, *or not*) and it would seem that, apart from allowing the capital resources so created to remain in the fund indefinitely, this is the only course a company can adopt.

It was held in *re Serpell & Co., Ltd.* (1944), that when redeemable preference shares were redeemed the nominal capital formerly represented by them disappeared, so that there was a reduction of capital. This decision has been reversed by section 58 which provides that the redemption of preference shares does not reduce the authorised capital of the company.

The illustrations below exemplify the book entries necessary upon redemption of redeemable preference shares out of profits:—

BALANCE SHEET.

	£		£
Redeemable Preference Shares	5,000	Net Assets (exclusive of cash)	6,000
Profit and Loss Account	7,000	Cash	6,000
	<u>£12,000</u>		<u>£12,000</u>

Upon redemption of the shares at par, the above becomes:—

BALANCE SHEET.

	£		£
Capital Redemption Reserve Fund	5,000	Net Assets	6,000
Profit and Loss Account	2,000	Cash	1,000
	<u>£7,000</u>		<u>£7,000</u>

Cash, to the amount of £5,000, has been expended in the redemption of shares, and an equivalent sum taken from profits to constitute the capital redemption reserve fund.

If the redeemable preference shares be redeemed at a premium, say, 10 per cent., £5,000 (i.e. nominal value of shares) must be transferred from the profit and loss account to capital redemption reserve fund, and an additional £500 taken from

profits to provide the premium. Cash is depleted by £5,500 to repay the shareholders. The result of these entries is as illustrated:—

BALANCE SHEET.

	£	£		£	£
<i>Redeemable Preference Shares</i>	5,000		<i>Net Assets</i>		6,000
<i>Less Transfer to Redemption Account</i>	5,000		<i>Cash</i>		6,000
	<u> </u>	—	<i>Less Repayment of Shares</i>	5,500	
				<u> </u>	500
<i>Profit and Loss Account</i>	7,000				
<i>Transfer to Redemption Account</i> ..	£ 500				
<i>Transfer to Capital Redemption Reserve Fund</i> ..	5,000				
	<u> </u>	5,500			
		<u> </u>			1,500
<i>Redemption Account.</i>					
<i>Transfer from Redeemable Preference Shares Account</i>	5,000				
<i>Transfer from Profit and Loss Account</i>	500				
	<u> </u>	5,500			
<i>To Cash (redemption of Shares), as per contra</i> ..	5,500				
	<u> </u>	—			
<i>Capital Redemption Reserve Fund.</i>					
<i>Transfer from Profit and Loss Account</i>	5,000				
	<u> </u>	£6,500			
		<u> </u>			£6,500

The entries required for redemption at a discount are illustrated by the skeleton balance sheet on the next page (assuming redemption at a discount of 10 per cent.):—

BALANCE SHEET.

	£	£		£	£
<i>Redeemable Preference Shares</i>	5,000		<i>Net Assets</i>		6,000
<i>To Cash (redemption), as</i>			<i>Cash</i>	6,000	
<i>per contra</i>	4,500		<i>Less Repayment of Shares</i>	4,500	
	<u>500</u>			<u>1,500</u>	
<i>To Capital Redemption Reserve Fund (profit on repayment)</i>	500				
	<u>—</u>				
<i>Profit and Loss Account</i> ..	7,000				
<i>Transfer to Capital Redemption Reserve Fund</i> ..	4,500				
	<u>2,500</u>				
<i>Capital Redemption Reserve Fund.</i>					
<i>Transfer from Redeemable Preference Shares Account</i>	500				
<i>Transfer from Profit and Loss Account</i>	4,500				
	<u>5,000</u>				
	<u>£7,500</u>				<u>£7,500</u>

The subject of redemption at a discount is one of academic interest only, as the issue of redeemable preference shares subject to such a provision would normally be impracticable.

An example of the conditions under which redeemable preference shares are issued is seen in the following extract from the prospectus of Carreras, Ltd:—

The "C" Cumulative Redeemable Preference Shares are, subject to the provisions of Section 46 of the Companies Act, 1929, redeemable at par together with a sum equivalent to all arrears (if any) of preferential dividend thereon (whether declared or undeclared) down to the date of redemption at the option of the Company at any time after the expiration of 20 years from the date of issue thereof and on or before the 31st day of December, 1973, upon not less than six calendar months' previous notice in writing being given by the Company to the registered holders for the time being thereof.

Any amount provided for redemption of redeemable preference shares must be shown in the profit and loss account (Eighth Schedule, para. 12), unless a consolidated profit and loss account is presented (section 149), when the amount must be shown in that account.

The advantages and disadvantages of redeemable preference shares are discussed in Chapter XV.

(6) *Ordinary Shares* were referred to earlier in this chapter when mention was made of those companies whose capital is divided into one class only. When preference shares of any type exist, the ordinary shares rank behind them for dividends. Provided the preference capital has no participating rights and there are no deferred shares, ordinary capital is entitled to the residue of profits disbursed in dividends.

(7) *Preferred Ordinary Shares* occupy a position between preference and ordinary shares or, where no preference shares have been issued, their status is equivalent to preference capital.

(8) *Deferred Ordinary Shares*. This class ranks behind ordinary shares for dividends.

(9) *Deferred Shares* rank behind all other classes for dividends, and their capital rights may be also delayed until all other capital has been repaid. They are sometimes issued to vendors as part of the purchase consideration, and, in some cases, constitute the directors' qualifications. Such alternative designations as vendors' shares, founders' shares, management shares, etc. are adopted in isolated instances. Deferred shares have not been commonly issued in recent years. Although such capital represents the most speculative investment available in an undertaking, it may acquire a very high value in a successful company. This phase of company finance is treated in Chapter XV.

RELATIONSHIP OF ONE CLASS TO ANOTHER.

It will be obvious that preference shares bear the same relation to ordinary that ordinary shares do to deferred, and that an identical arrangement may be expressed by saying either that one class of shares receives a dividend in preference to another, or that the latter class has its dividend deferred to that of the first named. It is entirely a matter of degree.

For a short period in the "thirties" it was fashionable for companies to divide their capital into ordinary and deferred shares. The former enjoy a prior right to a fixed cumulative or non-cumulative dividend, with or without participating rights, the deferred capital being entitled to the remaining profit distributed. The ordinary shares, therefore, occupy the

status of preference shares, and the deferred capital is tantamount to ordinary capital.

A matter which is frequently overlooked by prospective investors is the possibility of a company making a future issue of capital, consisting of preference shares which have priority over existing shares. Unless shareholders' rights are properly safeguarded in this respect by a suitable provision in the company's Memorandum, Articles, or the provisions of issue, the company may create shares having prior claims to dividends and capital without consulting the shareholders whose interests are prejudiced.

An example of a desirable protective clause is reproduced below. This was contained in the prospectus of Philip Hill & Partners, Ltd., in relation to an issue of 1,250,000 5 per cent. cumulative preference shares of £1 each at 21s. per share, and 1,250,000 ordinary shares of 5s. each at 15s. per share:—

"The Articles of Association provide that no Debentures, Debenture Stock, Mortgages or Charges (except to secure loans or overdrafts from the Company's bankers and others in the ordinary course of business) and no shares ranking in priority to or *pari passu* with the said Preference Shares shall be created by the Company without the sanction of an Extraordinary Resolution passed at a separate meeting of the holders of such Preference Shares and that the rights, privileges or conditions for the time being attached or belonging to such Preference Shares shall not be modified, affected, varied, extended or surrendered in any manner except with the sanction of an Extraordinary Resolution passed at a separate meeting of the holders thereof."

THE SHAREHOLDERS' EQUITY.

It was stated in Chapter II that it is customary nowadays for the shareholders' interest in the company to be grouped in the balance sheet, a sub-total being shown comprising issued capital, capital reserves and revenue reserves. Examples will be seen on page 13 and in most of the balance sheets in Appendix B. If, as is usual, any preference shares issued carry no rights to participate in surplus assets of the company, the deduction from this sub-total of the amount of preference capital will give the aggregate interest of ordinary shareholders, termed *the equity* of the company. This figure is the total amount which ordinary shareholders might expect to receive if the company immediately went into liquidation, assuming all assets realise their book values and the amounts shown for liabilities and provisions cover all debts and expenses to be met, including the costs of liquidation.

As mentioned in a later chapter on directors' reports, etc., net profit is very often expressed as a percentage of this "equity" in order to show the true earnings of the company on the *real* capital employed in the business.

HOW SHARES MAY BE ISSUED.

Shares may be issued at PAR, at a PREMIUM, or at a DISCOUNT. Par indicates the exact nominal value, a premium is the amount in excess of the nominal value (as in the issue by Philip Hill & Partners, Ltd., referred to on the opposite page), and a discount refers to the sum by which the issued price falls short of the nominal value, e.g. 10s. shares at 9s.

The Articles of Association usually provide that dividends shall be calculated on the nominal value, or such portion of the nominal value as is paid up. Thus, if £1 shares are issued at 25s. each, upon which 17s. 6d. has been paid (including the premium of 5s.), they will normally rank for dividend to the extent of 12s. 6d.

Companies may issue shares at par or at a premium without restriction.

Prior to 1929 it was illegal for a company incorporated under the Companies Acts to issue shares at a discount, the operation being tantamount to a reduction of capital. This inflicted hardship on companies who found it expedient to make an issue of a class of shares already in existence at a time when the market price was below par. An issue at par would meet with meagre response as the prospective shareholder could acquire his holding at less cost by purchase through his broker or banker.

This disability was remedied by the Act of 1929 (the provisions now being contained in section 57 of the 1948 Act), but it will be observed that the new facility was somewhat grudgingly introduced. The privilege of issuing shares at a discount is available, but is surrounded by many restrictions, of which may be mentioned:—

- (a) The shares must be of a class already issued.
- (b) Not less than one year must have elapsed since the company was entitled to commence business.
- (c) The sanction of the Court must be obtained.

Very little use has been made of this facility since 1929, but this may be attributable to more prosperous trade conditions since the passing of the original legislation.

TREATMENT OF PREMIUMS.

Premiums on shares constitute a profit to the company, but this profit is of a capital nature and must be retained in a special account (styled **THE SHARE PREMIUM ACCOUNT**) until such time as it is employed for the specific purposes mentioned on the next page. Prior to the Act (unless the Articles specifically provided otherwise) there was no legal objection to using premiums on shares for the purpose of dividends (see *Drown v. Gaumont British Picture Corporation, Ltd.*, at pages 194–195), but this practice was strongly deprecated for the following reasons:—

- (1) The profit belongs to capital and bears no reference to any particular trading period.
- (2) To issue preference shares at a premium, and transfer this profit to profit and loss account for the benefit of the ordinary shareholders amounts to “robbing Peter to pay Paul.”
- (3) Shareholders contributing the premium may justifiably contend that it should be retained in the undertaking, so that they may participate in the benefits therefrom.

What has, therefore, been for years the best accounting practice is now cloaked with statutory authority in section 56. This provides that the provisions of the Act relating to the reduction of share capital shall apply to all premiums on shares as if the premium account were paid-up capital.

The effect of this provision is to place the share premium account almost in the same position as the Capital Redemption Reserve Fund (explained on pages 119 and 120), i.e. apart from utilising the premium for the purpose of an issue of bonus shares, it will not be possible to disturb it without the sanction of the Court, except that section 56 allows the premium to be used to write off preliminary expenses, the expenses of, commissions paid, or discounts allowed on any share or debenture issues or in providing the premium payable on redemption of redeemable preference or debentures. The balance of the share premium account must appear in the balance sheet (Eighth Schedule, para. 2).

Share premiums in existence at the date the Act came into force must, if identifiable in the books, be regarded as subject to the foregoing requirements (section 56).

Doubts have arisen in cases where share premiums derived

in the past have been credited to revenue reserves, along with allocations of profit from year to year and a portion of these reserves has been utilised for the purposes of the company and/or for dividend appropriations. It may be impossible at this date to determine whether the amounts taken from reserves consisted, wholly or in part, of the premiums or the allocations from revenue. It would seem from the wording of section 56 that it is open to directors to decide at this stage whether in such circumstances any part or the whole of past premiums has been employed for some purpose before the Act came into force, and accordingly can "*be disregarded in determining the sum to be included in the share premium account*" as it does not "*form an identifiable part of the company's reserves.*"

In a memorandum dated 6th July, 1949, submitted by the Institute to the Board of Trade indicating certain matters for consideration on the revision of the Act or the Eighth Schedule thereto, attention is called to cases where a company acquires the whole of the share capital or the assets and undertaking of another company in exchange for an issue of its own share capital, and the paid-up value of the shares issued by the acquiring company is *lower* than the value of the acquired undertaking. The difference is a *premium*, and must be so treated in the accounts of the acquiring company.

The premium may in whole or in part reflect revenue reserves in the accounts of the acquired undertaking. It is suggested that in cases where there is such a premium and the identity of the persons holding the shares and the amount of their interest in the aggregate reserves of the companies are substantially the same before and after the acquisition, the shareholders should be entitled to have the share premium *treated as a revenue reserve* to the extent that it reflects revenue reserves of the acquired undertaking.

The memorandum suggests that power should be given to the Board of Trade, on application in such special circumstances, to relax the restrictions specified in section 56, and to permit the premium account to be used to an appropriate extent for revenue purposes. This would obviate the company being obliged to "freeze" the amount involved as capital, whereas it is, in fact, of a revenue nature.

An excellent example of the disclosure of additions to and deductions from the share premium account appear in a note attached to the accounts of Fisons, Ltd. (reproduced in

Appendix B). It will be noticed from the balance sheet (pages 395–396) that both ordinary shares and debentures have been issued during the year. The note (reproduced below) shows how the premium and discount on these issues have been dealt with:—

SHARE PREMIUM ACCOUNT.	FISONS, LTD.	GROUP
Balance as at 30th June, 1949 ..	£1,830,462	£1,863,803
Add: Premium on Issue of Ordinary Shares	110,964	110,964
	1,941,426	1,974,767
Less: Expenses and Commission on issues of Ordinary Shares and Debenture Stock	£172,182	
Discount on Issue of Debenture Stock	70,000	242,182
	£1,699,244	£1,732,585

A share premium account will also be seen in the balance sheets of Imperial Chemical Industries, Ltd., and Marks & Spencer, Ltd., in Appendix B.

In *Re Duff's Settlements Trusts, National Provincial Bank Ltd. v. Gregson and Others* (1951) the Court held that section 56 in effect created a new class of capital. In this case the trustees of certain settlements were precluded from distributing as income the moneys on the share premium account.

DISCOUNTS.

In the case of discounts, every balance sheet issued by a company subsequent to the issue of shares, must contain particulars of the discount allowed, or of so much of that discount as has not been written off at the date of issue of the document in question (Eighth Schedule, para. 3). The balance of the share discount account should accordingly appear as a separate item.

RESERVE CAPITAL.

A limited company may, by special resolution, determine that any portion of its share capital which has not been already called up, shall not be capable of being called up, except in the event, and for the purposes of the company being wound up (section 60).

The object of this procedure is to establish a "last line of trenches" in capital reserves, affording creditors (including debenture holders) added weight to their security.

ALTERATIONS OF CAPITAL.

The *authorised* capital of a company may be increased in such a manner as is prescribed by the company's own regulations. A notice of increased capital, with a 5s. registration stamp, must be filed with the Registrar, and the capital duty of 10s. per cent. paid. This increase relates to nominal capital, and must not be confused with increases to issued capital or paid up capital, which can be effected at any time, provided the authorised amount is not exceeded.

Capital may be decreased only with the consent of Court, and the Court, in making the order, will have regard to claims of objecting creditors, and may order them to be paid out, or their claims secured.

Section 66, relating to reduction of capital, should be carefully studied. It will be observed that in this section the word "capital" is used in three different senses, i.e. sometimes the nominal capital is reduced, but not the issued or paid-up capital; sometimes the issued capital; and sometimes the paid-up capital is reduced, either with or without a corresponding reduction in the nominal capital.

The reasons for effecting a reduction of capital may be summarised as under:—

- (1) When the whole of the paid-up capital is not represented by valuable assets. (For example, fixed assets may have become obsolete, or stock-in-trade depreciated by market conditions, etc., current revenue resources being inadequate to defray the losses.)
- (2) When trading losses have accumulated.
- (3) When the company is over-capitalised, it being impossible to remunerate adequately capital created.
- (4) When capital is in excess of requirements. Branches or departments may be closed down, or modern inventions render certain plant redundant.

Reduction of capital, courageously undertaken, has saved many companies from disaster, and enabled them to resume payment of dividends. Not only does the operation have the effect of eliminating "dead wood" from the assets in the balance sheet, but it reduces the field over which future dividends have to be spread.

CHAPTER IX

PROVISIONS AND RESERVES

PROVISIONS AND RESERVES CONTRASTED.

When the first edition of this book was published in 1938, the author strongly deplored the inadequacy of accounting nomenclature in this country which was unable to employ separate and distinct terms to denote (1) provisions made out of profits for specific purposes and (2) profits already earned which are set aside (i.e. *reserved*) for future use or for distribution. The expression "reserve" was loosely used to refer to either, and as they differ as widely as the proverbial chalk and cheese, the importance of designating each with a distinctive title was urged.

It is satisfactory to record that since that time confusion has been almost entirely removed by several official pronouncements and the clarifications have now been clothed with statutory authority in the Act.

The Institute of Chartered Accountants, in a memorandum issued in 1943, said "The terms 'reserves' and 'provisions' are commonly regarded as interchangeable. Accounts would be more clearly understood if the term '*reserve*' were applied only to reserves which are *free* and the term '*provision*' were confined to amounts set aside for specific requirements."

This recommendation clarified the matter considerably and there was soon a noticeable tendency to confine the word 'reserve' to the more limited use suggested in the memorandum.

In 1945 the Cohen Committee recommended that *provisions* and *reserves* should be shown separately in a company's balance sheet and profit and loss account, that additions to each, and the sources, should be disclosed and that deductions from each and the uses to which they are put should also be shown in the published accounts.

The Committee defined "*reserves*" as "any amounts which, having been set aside out of revenue or other surpluses, are free in that they are *not retained to meet any diminution in value*

of assets, specific liability, contingency or commitment known to exist at the date of the balance sheet."

This definition was generally welcomed as a much-needed and sharp distinction between "reserves" and "provisions," the latter being referred to in the Cohen Report as amounts set aside out of revenue to meet "any specific liability, contingency or commitment *known to exist* at the date of the balance sheet." The recommendations of the Institute were thus underlined by the Report.

The two terms are defined on similar lines in Part IV of the Eighth Schedule (para. 27) and an equally clear line of demarcation between the two is retained in the following terms:—

"The expression 'provision' shall . . . mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy."

"The expression 'reserve' shall not . . . include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability."

The Act (Eighth Schedule, paras. 6, 7 and 12) also broadly follows the recommendations of the Committee in requiring full disclosure of provisions and reserves (separately) in the balance sheet and profit and loss account, also their sources and the purposes for which they are utilised. Exceptions are made where the amounts are not material, also (in the case of amounts set aside to provisions) when the Board of Trade is satisfied that disclosure is not required in the public interest and would prejudice the company. An example of the circumstances when this might arise is the case of a disputed claim, where the disclosure of any provision might be liable to prejudice the company's defence in negotiation or litigation.

PROVISIONS.

A provision for a specific purpose is one that has been created by a charge made against profits (i.e. before arriving at the net profit or loss) in order to provide for an anticipated expense or loss attributable to the current year the amount of which can only be estimated.

It will be noticed that provisions are known liabilities "which cannot be determined with substantial accuracy." This brings us to a distinction between (1) liabilities accrued to the date of the balance sheet, and (2) provisions required at that date. The yardstick here would appear to be: can the liability be determined exactly or to a very near degree of approximation? If so, it is a liability. If an estimate has to be made, it is a provision.

Such items as rents, lighting, heating, telephone, etc., will normally fall under the heading of liabilities accrued, as also will all items outstanding at the date of the balance sheet for which invoices or statements are received between the date of the balance sheet and the time of making up the accounts. Wages and salaries for the few days remaining after the last pay-day to the date of the balance sheet will always be determinable by the first pay-day in the new financial year. By contrast, repairs, bad debts outstanding law charges or other professional fees, claims pending, current taxation, etc., are examples of liabilities which often "cannot be determined with substantial accuracy," and therefore fall under the heading of provisions.

Another purpose for which specific provisions are employed is to equalise expenditure over a period of years. A Repairs and Renewals Provision is a common example of this. An estimated sum (considered adequate to meet the cost of repairs and small renewals) is charged to the profit and loss account each year and credited to the provision account. The actual expenditure under this head is then charged currently to the provision account. In this manner fluctuations in the annual charges to revenue for repairs and renewals are "ironed out."

It is obligatory on the part of a company to make provision for all known losses and expenses, including a reasonable amount to cover contingencies, before arriving at the figure available for dividends, etc.

While "liabilities" and "provisions" now need to be segregated in the balance sheet, the distinction between the two is not a vital or fundamental one in the technique of accounting, since they are *both* charges against profit and any wrong allocation will not necessarily prevent the accounts displaying the requisite "true and fair view." For this reason, any prolonged consideration in practice of border-line cases between accruals and provisions is probably not worth-while.

The distinction between provisions and reserves is, of course, in an entirely different category. This distinction, as already emphasised, is of profound importance, and any neglect to observe it closely will undoubtedly distort the accounts and make it impossible for them to be presented in accordance with the requirements of the Act.

RESERVES.

A RESERVE exists when a company has refrained from devoting the whole of its profits to dividends, and has retained a portion for future use. It consists of appropriations from profits and other surpluses which have been earned in the past, i.e. amounts which are not designed to meet any liability, contingency, commitment or diminution in value of assets known to exist as at the date of the balance sheet. The objects of conserving the revenue resources of a company in this way are:—

- (1) To promote financial stability, i.e. to put aside funds for a "rainy day."
- (2) To equalise dividends (the reserve being drawn upon in years of depression).
- (3) To provide for future extensions and for replacement of assets at increased prices.
- (4) To avoid declaring excessively high dividends in years of prosperity which might create an impression (not always justified!) that commodity prices could be reduced.
- (5) To meet possible losses peculiar to the character of the company's operations (e.g. obsolescence of plant, changes of habit necessitating altered production, etc.).
- (6) To redeem loans (e.g. debentures) or Redeemable Preference Shares.
- (7) To set aside sums for future taxation liability (an operation which is discussed at some length later in this chapter).

In addition, profit earned in excess of dividends restricted by the prevailing "voluntary" limitation of dividends (see pages 252-255) is normally transferred to reserve.

Examples of reserves of appreciable dimensions in relation to the respective capitals of the companies will be seen in several of the Balance Sheets reproduced in Appendix B.

Other terms commonly used to denote a reserve are: Reserve Fund, Reserve Account, Surplus, and Rest. The word "Fund" should be restricted to those instances where the reserve is represented by specific investments outside the business. (In the report of the American corporation, Illinois Bell Telegraph Company, the reserve, designated "Stockholders' Surplus," is referred to as a "rainy-day fund.")

The provisions of the Act go a long way towards removing the confusion which is certain to arise if the terms, PROVISIONS and RESERVES are used indiscriminately. If it is appreciated that a provision arises out of an anticipated expense already consumed in the earning of profit, while a reserve is an accumulation of profits remaining at the company's disposal, the vital difference between these two credits will be understood.

Reserves are accumulations of undrawn profits, invested either within or outside the business. They represent revenue earned in the past and kept available for use or disposal in the future. Reserves belong to the shareholders, and the modern method of presentation in the balance sheet is to "group" them with other shareholders' funds, i.e. issued capital, capital reserves, and any credit "carry forward" from the profit and loss account. Conversely, any debit carried forward on profit and loss account should be shown within the same group by way of deduction.

It is worthy of mention that there is neither any legal nor any fundamental difference between a reserve and a credit balance accumulated on the profit and loss account.

One effect of the new legislation has been to bring to light reserves previously concealed. One prominent company, in publishing its first accounts after the coming into force of the Act, showed an increase in contingency reserves from £650,000 to £2,175,000. A note appended to the item indicated that approximately £1,400,000 was in respect of "reserves set up in previous years in respect of contingencies, trade debts and loans, investments, advertising and stocks, and formerly retained in *internal reserves*."

Although the distinction between provisions and reserves is defined in the Eighth Schedule, it is perhaps inevitable that its interpretation in a relatively few matters still remains to

be clarified, and much controversy on these topics is at present proceeding within the profession. The volume of publicity given to these discussions may in fact result in some loss of perspective. However valuable it may be for accounting students (and are we not all "students" as long as we practice accountancy?) to follow these controversies with an analytical mind, we must not overlook that, for example, future taxation (upon which debate has ranged so irrepressibly) is only one of many aspects of the subject, most of which give no difficulty when interpreting the provisions of the Act. The merit of the new legislation on provisions and reserves should therefore not be obscured by reason of the limelight now so strongly directed on a few controversial issues which, in themselves, imply no deficiency in the contents of the Eighth Schedule. These debatable topics are discussed at some length on other pages.

AN AMERICAN EXAMPLE

Attached to the balance sheet recently issued by the Caterpillar Tractor Co. in America is a statement showing how the reserve of \$75,624,952 has accumulated year by year since 1925! The reserve is designated in the balance sheet "Profit employed in the business."

This statement is a potent reminder to shareholders that the reserve has been built up out of profits, and the phraseology employed in the balance sheet throws a limelight on the fact that the reserve has a tangible representation on the other side, i.e. it is represented by assets. The statement shows for each of the twenty-six years the available profit, dividends distributed, other additions or deductions—the resultant balance, described as "Net change for year," constituting an addition to or deduction from the reserve.

EFFECT OF A RESERVE.

As the items on the liabilities side of the balance sheet have their contra in the shape of assets on the other side, a reserve represents an equivalent value in assets possessed by the company. This may be illustrated simply from the following progressive example, commencing with a skeleton balance sheet showing the position of a company:—

	£		£
Paid-up Capital ..	70,000	Sundry Assets	80,000
Profit and Loss Account		Cash	40,000
Balance	20,000		
Sundry Creditors ..	30,000		
	<u>£120,000</u>		<u>£120,000</u>

If the whole of the profit is distributed in dividends the position becomes:—

	£		£
Paid-up Capital ..	70,000	Sundry Assets	80,000
Sundry Creditors ..	30,000	Cash	20,000
	<u>£100,000</u>		<u>£100,000</u>

The cash balance has accordingly contracted to the extent of £20,000 and the total assets have been similarly reduced to £100,000.

If the company had confined its dividend allocation to £10,000, and transferred the balance of profit to reserve, the position would then be:—

	£		£
Paid-up Capital ..	70,000	Sundry Assets	80,000
Reserve	10,000	Cash	30,000
Sundry Creditors ..	30,000		
	<u>£110,000</u>		<u>£110,000</u>

This alternative enables the company to conserve £10,000 *in cash*. This sum might be utilised to acquire additional land, buildings or plant which would result in the assets representing the reserve becoming merged in the existing assets as illustrated below:—

	£		£	£
Paid-up Capital ..	70,000	Sundry Assets ..	80,000	
Reserve	10,000	<i>Add Additions</i>	10,000	
Sundry Creditors ..	30,000			90,000
	<u>£110,000</u>	Cash		<u>20,000</u>
				<u>£110,000</u>

Alternatively, the company's policy might dictate that the reserve be invested in government securities which would have the following effect on the balance sheet:—

	£		£
Paid-up Capital ..	70,000	Sundry Assets ..	80,000
Reserve Fund ..	10,000	Investments ..	10,000
Sundry Creditors ..	30,000	Cash ..	20,000
	<u>£110,000</u>		<u>£110,000</u>

In the last three balance sheets the reserve remains constant, but in each case the assets by which the reserve is represented change their character.

The reserve, therefore, continues so long as the assets in contra remain, irrespective of changes in such assets.

Conversely, the reserve may be extinguished despite the retention of the assets by which it was represented. This is exemplified by conceiving that in a succeeding year the reserve in the foregoing example is absorbed in the payment of dividends. Using the same figures for assets, capital and creditors, the position becomes:—

	£	£		£	£
Paid-up Capital		70,000	Sundry Assets ..		80,000
Reserve Fund ..	10,000		Investments ..		10,000
Less Transferred			Cash ..	20,000	
to Dividend			Less Dividend		
Account ..	10,000		paid ..	10,000	
					10,000
Sundry Creditors		30,000			
		<u>£100,000</u>			<u>£100,000</u>

Theoretically, the investments are now held to meet debts due to creditors and not, as hitherto, for reserve purposes.

Anxiety is often expressed that accumulated reserves lose much of their value when it becomes necessary to re-measure their prospective capacity to meet future contingencies at higher price levels, but this apprehension sometimes fails to recognise that the same economic force operates in a conflicting two-way fashion. Reserves retained within the business enjoy a value equal to the assets (fixed or current) which they represent. If the intrinsic value of those assets jumps ten per cent. overnight, a corresponding increment is attributable to the reserves.

It may be argued that this contention does not hold good if those reserves are invested in fixed assets, since increased replacement costs make additional inroads into profits. But

this argument needs triple-entry to support it, i.e. two debits and one credit, whereas one debit (to profits) and one credit (to replacement reserves) are obviously sufficient.

The ultimate effect of this adjustment is to take out of "available" reserves the sum needed to provide for replacement of the relevant fixed assets at their new values, and when replacement takes place (out of the now-adequate earmarked reserves) the remaining "available" reserves will be represented by a correspondingly enhanced intrinsic value in the shape of tangible assets.

A company is entitled to transfer such sums to reserve as it considers expedient provided:—

- (a) Its powers in this connection are not restricted by the Articles of Association, and
- (b) The interests of any class of shareholders is not prejudiced thereby.

It is unusual for Articles to place any restriction on the directors in recommending transfers to reserve. The following is an extract from Table "A" contained in the First Schedule of the Act, which is typical of the provisions contained in most Articles:—

"The directors may, before recommending any dividend, set aside out of the profits of the company such sums as they think proper as a reserve or reserves which shall, at the discretion of the directors, be applicable for any purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the directors may from time to time think fit. The directors may also without placing the same to reserve carry forward any profits which they may think prudent not to divide."

In *R. Paterson & Sons v. Paterson* (1916) it was held that articles requiring the distribution of profits in stated proportions between various classes of shareholders implied that none of the profit could be carried to a reserve fund. In the case of *Evling v. Israel Oppenheimer Ltd.* (1918) the Articles authorised an amount to be transferred to reserve fund, and it was held that any transfer in excess of that amount was illegal.

If profits transferred to a reserve have the effect of jeopardising the interests of a certain section of shareholders it would seem that an injunction could be obtained against the directors, since it is established that directors must act in the best interests of the company as a whole.

This might arise when part of the company's capital consisted of preference shares with non-cumulative dividend rights. Transfers to reserve in those years when no dividend was paid on the preference shares would place these profits permanently beyond the reach of the preference shareholders. Such accumulated profits would belong entirely to the ordinary shareholders and upon liquidation would merge in the assets [*Crichton's Oil Company* case (1901)]. But the Court would be very reluctant to compel directors to divide more than they thought proper (see *Bond v. Barrow Haematite Steel Co.* case on page 194). The rights of minority shareholders, as first introduced by the Act, are explained on page 221.

As already mentioned, the Act (Eighth Schedule, paras. 6 and 7) provides that reserves shall be shown *separately* in the balance sheet and all additions thereto (and the sources) and deductions therefrom (showing the manner in which such amounts are employed) must be disclosed in the balance sheet or statements annexed thereto (except where the amount involved is not material).

There is a tendency nowadays to "tidy-up" reserves in the balance sheet. For example, a company which now subdivides its reserves under the heads of:—

- General Reserve,
- Reserve for Future Income Tax,
- Profit and Loss Account Balance,

previously showed, in addition, the following reserves, which have now been transferred to General Reserve:—

- Contingencies Reserve,
- Plant and Obsolescence Reserve,
- Deferred Repairs Reserve.

ARGUMENTS FOR AND AGAINST "OUTSIDE" INVESTMENT OF RESERVES.

It is sometimes said that a reserve is "real" only when represented by specific investments outside the business. This statement is only a half-truth and is therefore misleading.

Dogmatism on the desirability or otherwise of investing the reserve outside the business is unwise. Each case must be decided on its own merits according to the prevailing circumstances.

The advantages of investment in reliable easily-realised securities may be summarised thus:—

- (1) The reserve is not endangered by depressions within the business, and it is therefore more effective as a "nest-egg" in times of need.
- (2) In the event of mismanagement or misfortune resulting in a loss of assets, the reserve remains intact.
- (3) Its value is available in cash at short notice without disturbance to the remaining assets.

It frequently happens, however, that the reserve can be more profitably employed in the business for the following purposes:—

- (a) Releasing bank loans, debentures, etc., carrying a higher rate of interest than could be obtained with safety on external investments.
- (b) Providing cash to defray the cost of extensions thereby obviating the creation of additional capital, loans, etc.
- (c) Enabling the company to meet current obligations without recourse to bank loans, etc.

PROVISIONS AND RESERVES FOR TAXATION.

Although the Act has clarified the distinction between provisions and reserves, the treatment of future liability for taxation has aroused controversy among accountants. Before discussing this rather complex subject, an explanation of the manner in which entries for future income tax arise may be useful. Apart from the early and last years of a company's existence, liability for income tax under Schedule D is assessed on the financial result of the last completed year prior to the start of the year of assessment, as illustrated below:—

Company's financial year ending on	Profits assessed in fiscal year, i.e. 6th April to 5th April	Tax payable on
1. 31st March, 1951	1951/52	1st January, 1952
2. 30th April, 1951	1952/53	1st January, 1953
3. 30th June, 1951	"	"
4. 31st December, 1951	"	"

It will be observed that the time-lag between the financial year in which profits are earned and the fiscal year in which those profits are assessed varies from 12 to 23 months, depending upon the balance sheet date of the company. (The due date of payment has been shown above for information, but this is no more significant in this respect than is, for example, the due date for payment of rent, rates, insurances, etc., when making apportionments each year.)

Income tax arising under Schedule "A" is assessed currently and needs adjustment only so far as a company's financial year does not coincide with the fiscal year. Profits tax is assessed on the profits of the financial year.

It is now a widely recognised practice for companies to charge in the profit and loss account taxation computed on profits to the date of the balance sheet, thereby giving rise to a credit for income tax due during a future accounting year or years. When this is not done in the profit and loss account, the trend of profits *after taxation* is not apparent since the charge in one year is based on the profits of a previous year and a substantial charge for taxation may easily be due in a year when a loss has been incurred! The Institute recommended in 1943 that "the charge for income tax should be based on profits earned *during the period covered by the accounts*" and also that in the balance sheet the estimated future liability should be *grouped with reserves or separately stated*. The point here is that taxation *due* after the date of the balance sheet must *not* be treated as a liability or a provision *but as a reserve*. Examples will be seen in the balance sheets reproduced in Appendix B.

Taxation due up to the balance sheet date is a liability if the amount *can be determined with substantial accuracy* when the accounts are made up; if the amount cannot be so determined it is a provision. As liabilities and provisions are "bedfellows" in both the profit and loss account and the balance sheet, this segregation is not important. But when we come to the treatment of amounts due *after* the balance sheet date, based on profits earned to that date, the vital distinction between provisions and reserves is well illustrated.

In *In re Joseph Duffy, deceased—Lakeman v. Attorney-General* (1948), it was held that the ordinary and natural meaning of the words "liability of the company" does not extend beyond legal liabilities actual existing at law at the relevant date.

"They did not cover something which, in a business sense, was morally certain to arise, but which in law did not become a liability until a subsequent date. Accordingly, they did not include income tax which would be payable in a subsequent year on profits earned now."

The objection to the concept that future liability for income tax is a reserve, voiced by a large section of the profession, arises out of the fact that many accountants cannot recognise amounts appropriated to meet taxation payments due in the future as free reserves. The trouble is that, while the Act draws a well-defined line between provisions and reserves, it offers no half-way house. An amount must fall on one side of the fence or the other—it cannot remain on top! And there seems no doubt whatever that future taxation must go on the reserves side of the fence. Moreover, there is not always a full appreciation of the fact that quite a sizable proportion of companies' reserves in this country is not in fact free for distribution if capital is to be maintained intact, owing to the incidence of inflation—a subject which is outside the scope of this chapter and is dealt with at a later stage in the book.

The main objection of accountants is that the inclusion of taxation in the revenue reserves group in the balance sheet distorts any comparison of the total of the group with the previous year's figure since future taxation is a fluctuating amount. Many companies have overcome the difficulty by showing future taxation as a separate item immediately below the reserves group so that the amount is not included in the total. In most instances the item is, in deference to the Act, described as "Reserve for Future Income Tax." There would appear to be nothing against this practice, which has the advantage of excluding the reserve from the balance sheet sub-total representing the shareholders' interest in the company.

The writer has expressed the view in several places that an amount set aside out of ascertained profits for a specific purpose does not necessarily lose its character as a free reserve, since the revenue account of a future year will be relieved of a debit when the liability for which profits have been *reserved* eventuates. The available profit of that future year will accordingly be augmented by reason of the debit being charged against the reserve instead of to revenue. In other words, the positive action of reserving for a future liability does not

(except temporarily) diminish free reserves, but merely defers their availability for other purposes. Moreover, if in an extreme case, a company went into liquidation when carrying a reserve for future taxation, the reserve would immediately become free owing to the improbability of any appreciable portion of it being required for the purpose for which it was earmarked.

It is true, of course, that the assessment in any one year may bear little relationship to the profit of that year, but that does not alter the fact that the statutory basis is merely one of government expediency and that from formation to liquidation a company is only liable for one year's tax in each year. To relate the burden of income tax to the measure of profit earned in each year is a matter of financial policy which (however commendable the practice may be) is merely the earmarking of undrawn profits to the relief of a future charge against such funds.

RELATIONSHIP BETWEEN CAPITAL ALLOWANCES FOR TAXATION PURPOSES AND DEPRECIATION.

Capital allowances for taxation purposes (i.e. initial allowances and annual allowances) nowadays amount in the first year of an asset's life to approximately 50 per cent., varying according to the nature of the asset (and are in fact over 70 per cent. for some assets!), the balance being spread over subsequent years in accordance with the appropriate rate for annual allowances. This large proportion of the original cost of an asset allowed in the first year is due to the *initial allowance*, which was increased from 20 per cent. to 40 per cent. by the Finance Act, 1949. The allowance will, of course, cease (except as stated on page 43) on 5th April, 1952.

Some companies favoured the practice of basing their normal depreciation calculations on income tax allowances as a means of keeping the two in step year by year, but, since 1949, the disparity in amount between the latter and provisions necessary to amortise the cost of assets over their useful working lives is so appreciable that any attempt to continue this practice has resulted in excessive charges to revenue for depreciation. It will be remembered that where depreciation "*is in excess of that which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated . . . as a reserve and not as a provision*" (*Eighth Schedule, para. 27 (2)*).

It has been contended that where depreciation is based on capital allowances for tax purposes, the abnormal provisions which are made in the year of expenditure are justified by the need for providing for replacements at increased costs. This argument is of extremely doubtful validity, as, quite apart from the fact that this extra provision suffers a gradual absorption over the lives of the assets, there is a general recognition that amounts set aside to meet increased replacement costs are reserves and not provisions.

A commendable practice is to appropriate to a *reserve* for future taxation amounts equivalent to income tax and profits tax on (a) capital allowances for taxation, *less* (b) the amount of depreciation charged in the accounts. This results in a taxation reserve being built up which is available to be drawn upon in later years when annual allowances fall short of depreciation charged in the accounts due mainly to the incidence of initial allowances.

A recent development seen in the accounts of some companies has been to open a reserve for deferred liability due to initial allowances so that the temporary relief obtained may be separated from the reserve for future income tax. This procedure has proved a convenience in practice and has been justified by the impossibility of envisaging future legislation affecting capital allowances—a justification which has been fully appreciated since the announcement that initial allowances are to cease in April, 1952. Examples of this reserve will be seen in the balance sheets of Imperial Chemical Industries, Ltd., and Fisons, Ltd., in Appendix B, while the special transfer of £415,000 to General Reserve in the Dunlop profit and loss account on page 398 is of interest in this connection.

We will take a simple example of a machine costing £1,000, upon which an initial allowance of 40 per cent. was allowed in the first year and an annual allowance of 10 per cent. (i.e. 8 per cent. plus $\frac{1}{4}$) was received. The profits tax has been ignored. Depreciation has been provided in the accounts at the rate of 15 per cent. per annum, on the diminishing balance basis and income tax has been calculated at 9/-:—

		Capital Allowances obtained and written-down value each year for income tax	Depreciation and Book Value of Asset	Differences between Capital Allowances and Depreciation	Annual Transfers to (Cr.) and from (Dr.) Reserve for Future Income Tax Account (taken at 9/-)
		£	£	£	£
Cost		1,000	1,000		
First Year:					
Initial Allowance	£ 400				
Annual Allowance	100	500	150	Cr. 350	Cr. 157
		<u>500</u>	<u>850</u>		
Second Year:					
Annual Allowance	..	50	128	Dr. 78	Dr. 35
		<u>450</u>	<u>722</u>		
Third Year:					
Annual Allowance	..	45	108	Dr. 63	Dr. 28
		<u>405</u>	<u>614</u>		
Fourth Year:					
Annual Allowance	..	41	92	Dr. 51	Dr. 23
		<u>364</u>	<u>522</u>		
				Cr. 158	Cr. 71

It will be seen that the amount brought back into the profit and loss account each year after the first has been income tax on the excess of capital allowances which would have been received for the year if based upon depreciation provisions over what has actually been received.

Unless adjustments of this nature are made, a year in which tax relief on initial allowances is obtained may show a larger available profit after charging taxation than is justified by trading results and the effect of this may be that, what is really only an *interest-free loan from the state*, is in danger of being distributed as dividends.

Similar adjustments may be necessary for such items as deferred repairs and other provisions, where a tax allowance is made in the year when the expenditure is incurred and not in

a previous year when the charge to revenue was made. (The profit and loss account of Olympia, Ltd., in Appendix B contains an adjustment in respect of taxation on deferred repairs.)

"A TRUE AND FAIR VIEW" OF TAXATION IN THE ACCOUNTS.

It is contended that if the overriding requirement of section 149 as to "*a true and fair view*" in both the profit and loss account and the balance sheet is to be adequately achieved so far as taxation is concerned it is necessary to:—

- (a) charge to the profit and loss account taxation *on the profit disclosed by that account* and
- (b) include in the balance sheet all taxation unpaid *on profits earned to the date of that statement*.

The former may be tested by the accountant when surveying his draft accounts by comparing the figure of taxation charged in the profit and loss account with the balance of that account after charging such taxation. As to income tax alone, when the rate of tax is 9s. 6d., the two figures should be capable of reconciliation in the ratio of 19 to 21 after taking into consideration all adjustments which have been necessary in the income tax computation, e.g.

- (a) disallowable and partially disallowable debits,
- (b) non-taxable credits,
- (c) expenditure allowed in a year other than that under review (due to the incidence of initial allowances, to the differences between annual allowances and normal depreciation charged and to transfers to and from provision and reserve accounts), and
- (d) any change in the standard rate of income tax for a future year or years, when this is known.

In the balance sheet the tax credit must be divided between (a) *taxation due at* and (b) *not due at* the date of the balance sheet, the former, as already mentioned, being a *liability* or *provision* and the latter a *reserve*.

In determining the amount of tax liability—or alternatively, provision, *if the amount cannot be determined with substantial accuracy* (Eighth Schedule, para. 27 (1))—at the date of the balance sheet, two practices are in vogue. The first assumes that all demands which have fallen due to the date of the balance sheet and are unpaid constitute the "legal" liability and the second calculates the liability by apportionment

to the date of the balance sheet. This may be exemplified by assuming that a company's financial year ended on 31st January, 1951, and the income tax liability for 1950/51 (due 1st January, 1951, but not paid until March, 1951) was £12,000. The first method would produce a liability of £12,000 whereas the second would be calculated at £10,000, being 10/12ths of the fiscal year 1950/51.

Again, if a company's balance sheet were prepared as at 31st December, 1951, and the Schedule A liability for 1941/52 was £800 (due and paid on 1st January, 1952) the first method would reveal no liability and the second, a liability of £600 (i.e. three quarters of £800).

The second alternative would appear to have more to commend it because, as mentioned earlier, the due date of payment of tax is not really significant.

BALANCING ALLOWANCES AND BALANCING CHARGES.

If tax on the difference between annual allowances plus initial allowances and depreciation provided in the normal course has been reserved annually, the aggregate sum set aside for future taxation should broadly take care of the position which will inevitably arise on the ultimate disposal or scrapping of assets in the incidence of balancing allowances or balancing charges, due to the differences in the book figures for assets and the written-down values for tax purposes. This, of course, obviates tax disproportionate to profit earned being charged in the profit and loss account in a year when assets are sold or scrapped.

To illustrate this it may be assumed that the machine which was the subject of the example on page 145 was sold for £600 immediately after the close of the fourth year. The position on disposal of the asset is set out below:—

	Written down value for income tax. £	Written down value in books £	Reserve for future income tax. £
Balance at end of fourth year (see page 145) ..	364	Dr. 522	Cr. 71
Proceeds of sale of Machine	600	Cr. 600	
Balancing charge on ..	236	@ 9/-	Dr. 106
Surplus on book value ..		Cr. 78 @ 9/-	Dr. 35

If the surplus on the books (£78) were credited to the profit and loss account, the tax suffered on this amount (£35) should have been transferred to the income tax account and in this manner the debit for taxation in the profit and loss account would not have been rendered inconsistent with the profit shown therein as affected by this disposal. Alternatively, had it been decided to transfer the book surplus of £78 to the credit of a reserve account (e.g. profit and loss on sale of assets account) the debit of £35 (being the excess of the balancing charge over tax reserved) should have been transferred to the same account so that the profit on sale of the machine was carried forward at the net amount, i.e. *after deduction of taxation incidental to disposal*.

This exemplifies how the burden of taxation can be dealt with in the accounts entirely parallel with the revenue to which it relates and in this manner revenue can be reflected in its net form, i.e. after it has been stripped of the imposts demanded from the State.

The foregoing examples assume, of course, a constant rate of tax (i.e. 9s.) throughout the life of the asset and for the sake of simplicity profits tax has been ignored.

TAXATION RESERVED BY SUBSIDIARY COMPANIES.

The validity of the contention that future taxation is a *reserve* is strained in one exceptional circumstance, i.e. when a company with profits reserved for future taxation becomes the subsidiary of another company. By the Eighth Schedule, para. 15 (5), profits earned by a subsidiary prior to acquisition by the holding company are capital profits and, as such, they are not, by a strict interpretation, available to meet tax payments. This matter is considered in the chapter on group accounts.

LOSSES CARRIED FORWARD IN THE ACCOUNTS.

The author considers, although many accountants will not share his view, that losses arising in occasional years may be dealt with by crediting revenue and *debiting* the reserve for taxation account with tax calculated on the agreed losses carried forward together with tax on capital allowances also carried forward.

This debit in the taxation reserve account can then be brought back by transfers to revenue in a subsequent year

or years when the losses and capital allowances are recouped. In the meantime a debit balance on the reserve account may justifiably be treated as an asset, representing an anticipated relief from taxation on future profits. The effect of these entries is, again, to relate the current revenue entry for taxation to the result disclosed by the profit and loss account each year.

It must not, of course, be overlooked that losses are available for only six years and even capital allowances carried forward may be lost if the company is liquidated. The foregoing procedure therefore needs to be exercised with some caution, and is inadvisable during any prolonged term of financial adversity.

CAPITAL RESERVES.

Up to this point attention has been confined to revenue reserves, i.e. those which have been derived from profits on trading.

The distinction between *capital* reserves and *revenue* reserves is brought out in the Act (Eighth Schedule, para. 27) which provides "*The expression 'capital reserve' shall not include any amount regarded as free for distribution through the profit and loss account and the expression 'revenue reserve' shall mean any reserve other than a capital reserve.*"

The Act also provides that the aggregate of such capital reserves must be shown in the balance sheet (Eighth Schedule, para. 6) and any additions thereto (together with the sources) or deductions therefrom (showing the manner in which the amounts have been employed) must be disclosed in the annual accounts or statements annexed thereto, except where the amount involved is not material (para. 7).

It will be observed that a capital reserve is one that is not regarded as free for distribution through the profit and loss account, that is to say, either its distribution via the profit and loss is legally prohibited or the directors have decided that by reason of its nature it is not free for distribution as dividends.

Two reserves in the former category have been referred to on previous pages, i.e. the Capital Redemption Reserve Fund, and Share Premiums, and a third, E.P.T. post-war refunds, is discussed later in the present chapter.

Among other capital reserves are the following, which are

invariably regarded as not being free for transfer to the profit and loss account:—

- (a) Profit applied to redemption of debentures.
- (b) Unrealised accretions to the value of fixed assets when the assets concerned are “written-up” in the balance sheet.
- (c) Profits derived prior to incorporation (see page 198).
- (d) A surplus arising on the acquisition of a subsidiary (see page 86).
- (e) Pre-acquisition profits of subsidiaries (see page 88).

The Institute has advocated that reserves set aside to meet replacement of assets at increased prices should be regarded as capital reserves, while amounts received on forfeited shares and profits on sales of fixed assets (see balance sheets of Morris Motors, Ltd., in Appendix B) are normally also capitalised.

Apart from the statutory capital reserves mentioned, a company may, subject to its articles, distribute as a capital distribution any part of its capital reserves. Incidentally, such a distribution could normally be made without deduction of income tax.

There does not seem to be anything in the Act which prevents transfers from “non-statutory” capital reserves to revenue reserves. It will be seen, therefore, that the line between the two is a thin one. By contrast, the “statutory” reserves (i.e. share premiums, capital redemption reserve fund and E.P.T. post-war refunds) are sacrosanct.

A typical example of a capital reserve will be seen in the balance sheet of Olympia Ltd. on pages 376–377. The Capital Reserve Account balance (shown at £201,760) was originally created by writing up Freehold Land and Buildings in accordance with the expert valuers’ figure referred to on the assets side.

The following is an example of a revenue reserve which becomes a capital reserve upon being utilised to repay a loan, e.g. debentures:—

	£		£
Paid-up Capital ..	10,000	Cash	2,000
Reserve	2,000	Other Assets	12,000
Debentures	2,000		
	£14,000		£14,000

It is assumed that the reserve has been built up for the purpose of redeeming the debentures at this date. When redemption takes place the Debentures and Cash balances disappear from the balance sheet leaving the reserve figure unchanged despite the fact that its function has been entirely fulfilled. The reserve now takes the place of the original capital loan as under and, as such, its designation is properly changed from that of revenue reserve to capital reserve.

	£		£
Paid-up Capital ..	10,000	Assets	12,000
Capital Reserve ..	2,000		
	<u>£12,000</u>		<u>£12,000</u>

A reserve is also capitalised when it is applied to the issue of bonus shares. This course may be considered expedient when it is invested in fixed assets. By converting the accumulated profits to capital the total Issued Capital figure is brought up to an amount which is more in accord with the value of the company's capital assets.

One or two matters in relation to a bonus issue may be referred to here which sometimes escape attention. The shareholder who becomes the recipient of a free gift of shares in this manner may find that the benefits which accrue are not quite so unqualified as they at first appear. Whilst admittedly the member's capital holding is increased, and the distribution comes to him without attracting income-tax, the intrinsic value of each share will tend to diminish in proportion to the increased capital. This tendency exists because the value of the company's assets has not increased by one farthing by reason of the augmentation of capital. This will be apparent from the example appended below:—

	£		£
Paid-up Capital ..	20,000	Assets	35,000
Reserve	10,000		
Sundry Creditors ..	5,000		
	<u>£35,000</u>		<u>£35,000</u>

If the reserve be capitalised by an issue of Bonus Shares the issued capital will be thereby increased from £20,000 to £30,000. As the net assets (i.e. assets less creditors) amount to £30,000 it will be seen that whereas each £ of capital was

originally represented by 30s. value in assets, each £ now becomes worth only 20s. To give an example, Daily Mirror Ordinary Shares were quoted at 33s. 3d. before a "one-for-one" bonus in July, 1951, and at 16s. 6d. "ex-bonus" immediately afterwards. It is not suggested that in practice the market price of the shares would in all cases immediately fall in the same proportion. The intrinsic value of shares expressed in terms of assets per £ of capital is only one of the factors that go to influence market valuations.

From the revenue aspect also the shareholder may not appreciably benefit, as future profits earned by the company will require to be spread over a larger field of capital. The rate of dividend will accordingly be proportionately reduced.

The controversial aspects of bonus issues and the existing government restrictions are discussed at some length on pages 248-250.

Capital reserves, except those the employment of which is legally restricted, may be used:—

- (1) To defray capital losses, e.g. "writing down" assets which are over-valued, eliminating "dead wood" from the assets side of the balance sheet, i.e. accumulated losses, preliminary expenses, patent rights, development expenditure, etc.
- (2) To meet capital expenditure, e.g. costs of issuing shares and debentures, writing-off discounts on shares and debentures, etc.

SECRET RESERVES.

When a company's actual financial position is better than that shown in the accounts, a SECRET RESERVE is said to exist. Secret reserves, commonly referred to as *inner reserves*, are brought about by:—

- (1) Under-statement or omission of assets, fixed or current (by charging capital expenditure to revenue) and/or
- (2) Creation of excessive provisions, or overstatement of liabilities.

The general conclusion reached by the Cohen Committee was that secret reserves are undesirable, it being important "to ensure that there should be adequate disclosure and publication of the results of companies so as to create confidence in the

financial management of industry and to dissipate any suggestion that hidden profits are being accumulated by industrial concerns to the detriment of consumers and those who work for industry."

It was accordingly recommended that companies be required to disclose all reserves (including capital reserves) and provisions in the balance sheet and to show all transfers to and from such reserves and provisions in the profit and loss account. In accordance with the Act, *both the creation and utilisation of reserves are obligatory subjects of disclosure* (Eighth Schedule, para. 7).

The Act makes exceptions, however, in the case of banking, discount and assurance companies, whose stability is a national asset of the first importance and who may advantageously be allowed to retain undisclosed reserves as a buffer against political disturbances and economic conditions, both national and international (Eighth Schedule, paras. 23 and 24). These exceptions may also be extended by the Board of Trade to any other class of companies when desirable in the national interest (Eighth Schedule, para. 25). Shipping companies have been included in this category since 1948, subject to the conditions set out in the Companies [Shipping Companies Exemption] Order, 1948. Up to the end of 1949 17 applications under this Order were received by the Board, 16 being entertained and one refused, the figures for 1950 not being available at the time of going to press.

A further qualification is made in the Act to the effect that where the Board of Trade is satisfied that disclosure of provisions would be prejudicial to a company's interests and is not required in the public interest, the amounts concerned need not be shown separately, but may be included under other headings if appropriate words are used to indicate that provisions of this character are included therein (Eighth Schedule, paras. 6 and 12).

As already stated, any amount set aside for depreciation, renewals or other known liabilities *in excess of that which*, in the opinion of the directors, *is reasonably necessary for the purpose* must be shown as a *reserve and not as a provision* (Eighth Schedule, para. 27).

Auditors will be well advised to report if they think, contrary to the opinion of directors, that an amount should be treated as a reserve and not as a provision.

The provisions of the Act prevent most of the abuses of the past relating to secret reserves. Moreover the exceptions will, for the most part, obviate suppressing legitimate development and will avoid conflict in matters of public policy.

As auditors are required to report whether the accounts give the information required by the Act, it would seem that directors will find it difficult in future to create provisions for depreciation, renewals, taxation, stock, etc., etc., in successful years in order to "iron-out" profit fluctuations by the manipulation of reserves.

Although these provisions will meet with approval in most quarters, it must not be assumed that secret reserves are now entirely non-existent in the accounts of companies. As explained in Chapter III, the valuation of fixed assets for balance sheet purposes is in the nature of an historical record of their worth. In determining this valuation by processes of depreciation there is an inevitable and commendable tendency to err on the side of prudence. This inevitability is unrecognised in accountancy textbooks, but it is a feature present in almost every business. Again, provisions are estimates which may be liberal without invoking the terms of paragraph 27 of the Eighth Schedule.

A consideration which sometimes escapes attention, is that a secret reserve arising out of the under-valuation or omission of a fixed asset may survive for a considerable period, but one derived from the under-statement or omission of a current asset or over-statement of a provision requires renewing each year to maintain its continuance.

It is paradoxical, but nevertheless a truism, that in some instances a secret reserve is so presented that a limelight of publicity is thrown upon it. This occurs whenever an asset is shown in the Balance Sheet at a figure which obviously represents a nominal value only. A case in point may be seen in the balance sheet of Olympia Ltd. on page 377, i.e. Plant, Machinery, Furniture, Fixtures, Fittings and Exhibition Accessories at 31st December, 1946, £100; and a more pronounced example in the item: Patents and Goodwill, £1, in the balance sheet of Gestetner, Ltd. (page 380).

These secret reserves should be contrasted with that of Marks & Spencer, Ltd. on page 371. In this balance sheet, goodwill is omitted, although the existence of a valuable goodwill is apparent from the profits earned. Its exclusion,

however, will pass unobserved by many of those who peruse the balance sheet.

No legislation, of course, can entirely preclude the possibility of secret reserves being created, but the Act probably goes as far as any statute could do in this direction, as the sources of additions to reserves and the destinations of withdrawals therefrom are required by the Eighth Schedule to be revealed. It is quite obviously the intention of the Act to prevent the creation of any appreciable secret reserves and also the utilisation without disclosure of any hidden resources which already exist. The dangers inherent in practices which involve the manipulation of profits are apparent, and no justification can be advanced for deliberate misrepresentation in accounts. That, of course, has always been true. The significance, however, of the new legislation is that secret reserves are, on the face of it, prohibited and it is not open, as hitherto, for directors to justify such practices in the interests of the company.

This is consistent with the provisions of the Act in general, which aim at making the published accounts of companies more informative and reliable, and is a reform which, on balance, will prove advantageous.

CONTINGENT LIABILITIES AND COMMITMENTS ON CAPITAL ACCOUNT.

Companies may have liabilities at the date of the balance sheet which have not materialised and which, by their nature, are insufficiently concrete to warrant specific provision being made in the accounts for them. Examples of such items are:—

- (1) Bills of exchange under discount.
- (2) Uncalled liability on shares held as investments.
- (3) Arrears of dividend on cumulative preference shares.
- (4) Guarantees given to other parties.
- (5) Conditional liabilities under contracts.
- (6) Liabilities on claims pending.

It has been a customary practice for a long time for companies to append a memorandum note at the foot of the balance sheet stating the nature of the contingent liability,

sometimes with the inclusion of the estimated amount involved, as shown below:—

Contingent Liability.

Bills under discount at 31st December, 1951,
amounted to £14,850.

A note, in memorandum form, was also occasionally inserted at the foot of a balance sheet furnishing information as to commitments already entered into in respect of future capital expenditure. The amounts involved were not, of course, included in the totals of the balance sheet, as they would not be passed through the books until a subsequent date when the constructional work was carried out.

References to contingent liabilities and capital commitments will be seen in some of the accounts contained in Appendix B.

The foregoing practices are now compulsory (Eighth Schedule, para. 11) and, where practicable, the aggregate amount or estimated amount should be shown.

OTHER MEMORANDUM NOTES REQUIRED BY THE ACT.

It is provided that companies shall be required to include a note on the balance sheet, or in any statement or report annexed thereto, if not otherwise shown, of the following matters (Eighth Schedule, para. 11):—

- (a) Where, in the opinion of the directors, the current assets have not a value realisable in the ordinary course of business of the company of at least the amount at which they appear in the balance sheet, a statement to that effect.
- (b) Where any material part of the assets or liabilities comprises foreign currency assets or liabilities, the basis of conversion from foreign currency into sterling for balance sheet purposes.
- (c) Particulars of any charge given over the property of the company for the debts of another person and also, where practicable, the amount thereof.
- (d) The *gross* amount of arrears of fixed cumulative dividends on any class of share and the date to which such dividends were last paid (except in the case of "tax-free" dividends, when the amount shall be shown "free of tax" and the fact that it is so shown shall be stated).

- (e) Where a company has given an option to any person to subscribe for its share capital, the number and amount of shares affected, the class of share, the option price and the date or dates for exercise thereof.
- (f) The basis on which the amount, if any, set aside for United Kingdom income tax is computed.
- (g) The aggregate market value of the company's quoted investments, other than trade investments, where it differs from the balance sheet amount, and the stock exchange value, if lower than the value shown.

Matters relating to the profit and loss account, which are required to be shown by way of note, if not disclosed in the account (Eighth Schedule, para. 14), are dealt with in Chapter XI.

EXCESS PROFITS TAX POST-WAR REFUNDS.

The Finance Act, 1946, fixed the date for the cessation of Excess Profits Tax as 31st December, 1946. The statutory promise to make a partial and conditional refund of E.P.T. payments was, until the passing of the Finance (No. 2) Act, 1945, in such vague terms that the matter was justifiably ignored in company balance sheets. This Act provided that the *net* amount of the refund (i.e. after deduction of income tax) must be used in *developing or re-equipping the trade or business* and any part which is not so used shall NOT be distributed by way of profits to shareholders.

The Institute issued in July, 1946, recommendations in regard to the treatment in accounts of refunds (which are, in the case of some companies, of considerable amount). As at that time there was no official interpretation of the statutory provisions it was inevitable that the recommendations were tentative and incomplete. It was advocated that, where the amounts are material, *it should no longer be regarded as good accounting practice to ignore the right to refunds*. Where the amount can be ascertained, or has been received, it should be credited to a specific reserve or suspense account, under an appropriate name such as "*Excess Profits Tax Post-War Refund Suspense Account*." Examples will be seen in the balance sheets of Imperial Chemical Industries, Ltd., and Dunlop Rubber Co., Ltd., in Appendix B. If the amount has not been received, it should also be shown separately as an

asset, e.g. "*Amount Recoverable in respect of E.P.T. Post-War Refund.*"

If the cash has been received it is required to be kept available to meet the prescribed conditions of the refund—and the Institute recommended that, if necessary, it be kept in a special bank account employed for the purpose.

In November, 1946, the Excess Profits Tax Refunds Advisory Panel, appointed by the Treasury, made an official announcement of the principles to which it will work in carrying out the duties laid upon it by the Act.

It is made clear that the Panel will expect the increase in the net worth of a business arising from the receipt of a refund (that is the capital and reserves of a business, as represented by the excess of the assets over the liabilities) to be shown and *maintained* separately on the balance sheet as a *capital reserve*.

The expressions "development" and "re-equipment" are defined in the official statement. Development will be clearly identifiable where the refund has been used to expand the capital employed in the business as represented by fixed assets and working capital of the business. The reduction of a bank overdraft or the discharge of other liabilities will be regarded as such an expansion of capital.

The Panel will be prepared to regard as development, expenditure out of the refund on special advertising, research and other similar expenditure aimed at improving the business, provided that it is capitalised and treated as a capital asset against reserves. Expenditure of this nature must not be charged to the profit and loss account.

The Panel will regard as re-equipment any expenditure on assets where the effect is to increase the efficiency of buildings, plant, machinery, equipment, etc.

To the extent that relief from taxation falls short of the expenditure, rehabilitation expenses as defined by the Finance Act, 1946 (broadly speaking, expenditure on the removal of A.R.P. installations, the return of evacuated businesses and the readaptation of buildings, plant, machinery, etc., for peacetime production) may be charged against the refund. Expenditure on deferred repairs is not, however, admissible.

The normal test to be applied by the Panel in determining whether or not any part of a refund has been directly or indirectly distributed for the benefit of proprietors will be *the movement of the net worth of the business*, due regard being paid

to the normal level of depreciation provisions and to the course of profits and their disposal. In any period in which the distribution of profits for the benefit of proprietors exceeds the profits of that period, the Advisory Panel would feel obliged to satisfy itself that the undertakings given in respect of the refund were not being infringed. It would seem that the vigilance of the Panel will have to continue for many years unless there is to come a time when the "reconstruction emergency" may be said to be at an end and companies relieved of their obligations in this connection.

It is suggested that directors should show in their report, or in the accompanying accounts, how a refund has been used. The Act requires that until the refund has been used for developing or re-equipping a business, it is to be "*so dealt with as to remain available for use, when required, in developing or re-equipping the trade or business.*" As long as any part of a refund remains unused, the Panel will be assisted in carrying out its duties if any such unused part is *separately distinguished* among the assets of the business. In this connection, investment in Government or other marketable securities will be regarded as complying with the requirement that a refund shall remain available for use.

The Act provides that any part of the refund used in or towards the recoupment of expenditure in developing or re-equipping a business which has been incurred on or after 1st April, 1945, is to be regarded as expenditure which satisfies the undertakings given in respect of the refund.

In September, 1949, the Secretary of the Panel indicated that, provided it is quite clear that the full amount of the refund itself has been properly used, objection would not be raised to the capital reserve created by the receipt of the refund being capitalised—either alone or in conjunction with other reserves—for the purposes of an issue of bonus shares.

The only alternative open to companies is to retain the credit balance as a capital reserve indefinitely.

CHAPTER X

DEBENTURES

BORROWING POWERS OF A COMPANY.

Trading companies have an implied power to borrow, if such borrowing is properly incidental to the conduct of the business. Such powers are, however, more usually derived from the Memorandum or Articles of Association, and may be limited to a specified sum, or to the amount of issued capital, or the uncalled capital. If a Stock Exchange quotation is sought by a company, the Memorandum or Articles must fix a reasonable limit to the company's borrowing powers.

It is quite usual for companies to augment the amount received as capital from shareholders by negotiating short and/or long-dated loans on the most advantageous terms obtainable. This may be done in various ways: by unsecured loans, by making or discounting bills of exchange or promissory notes, by mortgages on the property of the company and, most commonly, by an issue of debentures.

GENERAL NATURE OF DEBENTURES.

Debentures are bonds given under the company's seal and are legal evidence of a debt, and the company's obligation to pay interest at a specified rate. A debenture usually gives a charge on property of the company as security to the debenture holder.

Debentures may be issued to a creditor in respect of an existing debt, or a fresh loan, or as collateral security. They are, however, usually offered for public subscription in a similar manner to shares, and afford a prospective investor an alternative form of investment in the company.

STATUS OF DEBENTURE HOLDERS.

A debenture holder is a creditor of the company, and is entitled to interest at a specified rate whether profits are earned or not. His relationship differs therefore from a shareholder who is a member (i.e. a part proprietor) of the company, and whose income is derived solely from profits. Moreover, a debenture holder usually possesses security for his loan,

whereas a shareholder has no security. Against these advantages enjoyed by the former, it must be remembered that he has no claim on the profits of the company (except in isolated cases) and however successful the business may prove to be, his income is limited to the rate of interest stated in the debenture.

Debentures, therefore, appeal to the more cautious investor who is content with a steady income provided this is accompanied by maximum capital security.

SECURITY FOR DEBENTURES.

Unsecured debentures (sometimes known as "naked" debentures) may be issued, but it is more usual for assets to be charged in favour of the debenture holders. The security may take the form of a specific mortgage or a floating charge, or a combination of both, and these will be described on succeeding pages.

An unsecured debenture is merely a promise to repay the capital sum lent, and is of scarcely higher value than a promissory note. The holder of such a debenture is only able to prove in the capacity of an ordinary creditor in the event of the company winding up.

When debentures are secured by a charge on the company's property, the charge may be created by words in the debenture itself, or by a deed, the benefit of which the debenture holders are declared to be entitled, or by a combination of these two methods.

THE TRUST DEED.

When debentures are issued for public subscription a trust deed is invariably executed in favour of the debenture holders, a trustee being appointed (and remunerated) by the company to act on behalf of the debenture holders.

The trust deed contains, *inter alia*, the following clauses:—

- (1) Particulars of the property charged as security, and whether by specific mortgage or floating charge, or both.
- (2) Whether the company shall have power to create any mortgage having priority to the charge included in the deed.
- (3) Provision for redemption of the debentures, including the price and date or dates at which they shall be redeemed, and whether by drawings, purchase in the market, or by ordinary redemption. If a sinking fund is to be created out of profits to provide for redemption, details of this will be included in this clause.

- (4) Powers of trustees to deal with the assets charged as security in the event of default by the company in payment of interest, or repayment of capital, or upon a winding-up.
- (5) Whether the debentures shall be in registered or bearer form and, if issued as debenture stock, in what minimum multiple it shall be transferable.

When a trust deed is in existence, the debentures themselves should contain a clause incorporating its terms by reference.

By section 87 of the Act every debenture holder has the right to a copy of any trust deed for securing the debentures he holds on payment of a sum not exceeding one shilling in the case of a printed trust deed, or on payment of sixpence for every hundred words required to be copied where the trust deed has not been printed.

The trustee appointed by the company to look after the interests of the debenture holders may be an individual or a corporate body. It is usual to appoint a finance or insurance company to act in this capacity.

FIXED AND FLOATING CHARGES.

A fixed charge takes the form of a mortgage on specific property of the company. When land, buildings, etc. are mortgaged, the company is unable to deal with the assets involved (i.e. by way of creating a prior charge or by disposal), except subject to the terms of the mortgage. Upon repayment of the debentures the mortgage is released to the company.

A floating charge* does not prevent the company from dealing with the property so charged in the ordinary course of business. It may embrace movable (i.e. current) assets as well as fixed assets, and the property so included may change its character in the conduct of the company's business. For example, stocks will automatically change to debtors' balances and cash; debtors' balances will liquidate into cash, and cash will be expended in new stocks, etc. Uncalled capital and future property are frequently contained in the charge. Not until a floating charge becomes fixed, or as it is often termed, "crystallises," is the company precluded from disposing of the assets involved.

The circumstances in which a floating charge crystallises (e.g. failure on the part of the company to pay interest on the due dates, or neglect to satisfy the provisions as to redemption), are enumerated in the debentures or the trust deed.

* Floating charges are not created in Scotland.

The advantage of a fixed charge over a floating charge lies in the fact that the debenture holders know to which particular assets they may look for security, if the need arises. Against this, the security afforded is restricted to specific assets which may shrink in value. Buildings erected for the especial purposes of the business are often saleable only at considerable loss.

When debentures are secured by a floating charge, the holders may rely upon any assets included in the charge for satisfaction of their claims, even though certain assets may not have been in existence at the time the charge was created.

A risk is always present that, in the event of a prolonged period of depression ensuing, a company's assets may become partially consumed in an attempt to avert financial disaster. This eventuality would result in a contraction of the security furnished by a floating charge. The widest security is not therefore necessarily the best, and each should be valued on its merits.

The extracts from prospectuses, reproduced below, illustrate typical debenture securities. The first exemplifies a specific mortgage; the second takes the form of a floating charge, while the third is an example in which a combination of both has been included in the trust deed,—a not uncommon practice:—

- (a) "The stock will be secured by a first specific charge upon the leasehold property of the Company, situate in Piccadilly, London, W.1, which is held under a direct Lease from the Crown for a term of ninety-nine years from the 5th April, 1935, at the rent of a peppercorn if demanded for the first year, £5,500 for the second year, and £11,000 for the third and every subsequent year of the said term, and on the building erected thereon by the Company and on all fixtures and fittings thereon."
- (b) "The Stock is constituted by a Trust Deed in favour of the Prudential Assurance Company Limited (as Trustees for the Stockholders) and is secured by a First Floating Charge on the undertaking property and assets of the Company, present and future, including its uncalled capital. The Trust Deed while permitting the Company to deal with and dispose of its property in the ordinary course of business precludes the creation without the Trustees' consent of any mortgage or charge ranking in priority to or *pari passu* with the charge thereby created except a charge to secure a further £100,000 of Stock ranking *pari passu* as to security with the Stock but carrying such rights as to interest redemption and otherwise as the Company may require and charges upon specific assets or property ranking in priority to or *pari passu* with the Stock to secure temporary loans

from Bankers or others in the ordinary course of its business but so that the amount of such loans when added to the amount for the time being outstanding of the Stock and such further Stock as aforesaid shall not without the consent of the Trustees exceed one-half of the nominal amount of the issued share capital of the Company for the time being."

- (c) "SECURITY.—The Debenture Stock will be secured (subject to the existing 6 per cent. Debenture Stock until redeemed) by a Trust Deed in favour of the Law Debenture Corporation Limited as Trustees, which will contain (*inter alia*) provision for the following:—
- (1) A specific first charge on all the freehold and leasehold properties of the Company.
 - (2) A specific first charge upon the shares which the Company holds in its various subsidiary Companies and an associated Company.
 - (3) A first floating charge upon the undertaking and other assets of the Company present and future, including any of its uncalled capital for the time being.
 - (4) That the Company shall not without the previous sanction of an Extraordinary Resolution of the Debenture Stockholders create any charge on its assets comprised in the floating charge ranking in priority to or *pari passu* with the Stock except charges in favour of its Bankers to secure overdrafts in the ordinary course of business and charges upon any after-acquired freehold or leasehold property."

ISSUE OF DEBENTURES OR DEBENTURE STOCK.

Debentures or debenture stock may be issued in a similar manner to shares, i.e. through the medium of a prospectus, which must comply with the Fourth Schedule. If the aggregate loan is divisible into units (e.g. £1, £10, £100, etc.), each unit is termed a debenture, and is transferable only in its entirety. Debenture stock, by distinction may be split into any multiple, subject to a minimum multiple, which is usually fixed by the deed at £1. Debenture stock must be fully paid, but debentures may or may not be, although it is the usual practice for them to be fully paid up within a few months of issue.

It will be seen, therefore, that the difference between debentures and debenture stock corresponds with the distinction between shares and stock.

The similarity between share capital and debenture loans extends also to the price at which they may be issued, i.e. at par, a premium or a discount (but the provisions of section 57,

relating to an issue of shares at a discount, do not apply to debentures).

Accordingly if debentures are issued at a premium, the premium constitutes a capital profit to the company, and should be treated as such. In many instances it is used to write-off expenses of issuing the loan, any balance forming the nucleus of a fund to provide for its redemption.

STATUTORY REQUIREMENTS.

The Eighth Schedule (para. 3) provides that any expenses incurred in connection with any issue of share capital or debentures so far as they are not written off, shall be shown under a separate heading in the balance sheet and makes it obligatory for a company to show any sums paid by way of commission and any sums allowed by way of discount on debentures, in every balance sheet until the whole amount has been written off.

Paragraph 10 provides that where debentures are held by a nominee of or trustee for the company, the nominal amount of the debentures and the amount at which they are stated in the books shall be shown in the balance sheet.

REGISTERED AND BEARER DEBENTURES.

The holder of registered debentures is registered in the books of the company in a similar manner to a shareholder. Transfer can accordingly be effected only by written transfer; such transfer being registered with the company, and a transfer fee (usually 2s. 6d.) paid.

Alternatively, a debenture may be in "bearer" form, i.e. transferable by mere delivery. The interest due is paid to the holder, irrespective of his identity, at each interest date. Coupons are frequently attached to the debenture, for presentation through a banker on the due dates.

A bearer debenture is therefore possessed with the attributes of a bank note or coin of the realm from the point of view of its transfer. It is negotiable, i.e. legal ownership passes by mere delivery, no written transfer being necessary to vest it in a purchaser. The obvious disadvantage of a bearer debenture is that, in the event of it being lost or stolen, the finder or thief is able to give a *bona fide* purchaser from him for value as good a title to it as the true owner could have given.

DEBENTURES IN THE BALANCE SHEET.

The requirements of the Act in regard to showing as separate items in the balance sheet expenses of issue, commissions paid, and discount on debentures until such amounts are written off have been referred to. These items will accordingly appear on the assets side, and as they represent "dead wood," most companies will take early steps to write off such items to revenue.

A further statutory requirement in regard to debentures is contained in the Eighth Schedule (para. 2) which requires that particulars of any redeemed debentures which the company has power to re-issue shall be given in the balance sheet.

Debentures or debenture stock appear as a liability and the figure shown represents the full nominal paid-up value of the loan upon which interest is calculated, i.e. after deduction of any premium, or addition of any discount.

Any premium received upon the issue of debentures should appear as a capital reserve until such time as it is employed for some purpose.

REDEMPTION.

Companies have power, under section 89, to issue irredeemable debentures, but instruments of this nature are extremely rare in practice. Usually the date on or before which the loan must be redeemed is stated in the provisions of issue. The following extracts from prospectuses represent typical provisions for redemption:—

"The Stock is to be repayable at 102½ per cent. on the 1st April, 1960. The Company will reserve the right to repay at 103½ per cent., together with accrued interest, the whole (but not a part only) of the Stock on or at any time after the 1st April, 1942, upon giving three months' notice in writing."

"The Company will be entitled to redeem the whole, but not a part only, of the Stock for the time being outstanding at any time after the 31st March, 1940, at £104 per cent., plus accrued interest, on giving three months' notice in writing to the holders of the Stock. Repayment in consequence of the winding-up of the Company at any time will be at the same premium.

"Any Stock not previously redeemed and cancelled will be redeemed on the 31st March, 1971, at £102 per cent."

"The Trust Deed will further provide that the Company shall redeem in each year, commencing with the year 1938, by purchase or drawings (subject to appropriate increase if any further part of

the £4,000,000 Stock be issued and with power to anticipate purchase) £52,500 nominal amount of the Stock together with a further nominal amount equal to one year's interest (free of Income Tax) on all Stock previously so redeemed. Purchases of Stock for this purpose will be at or below 103 per cent. (inclusive of expenses of purchase, but exclusive of accrued interest) and redemptions will be by drawings at 103 per cent. The Company will also reserve the right to redeem the whole or any part to be selected by drawings of the outstanding Stock on giving not less than three calendar months' previous notice, such redemption to be at 107 per cent. if before the 1st July, 1938, and at 105 per cent. if on or after that date and before the 1st January, 1969.

"Any of the Stock not previously redeemed will be repayable at 103 per cent. on the 1st January, 1969. In the event of a voluntary winding-up before that date for the purpose of reconstruction or amalgamation, the Stock will be repayable at the same price as if notice has been given to redeem at the date of commencement of the winding-up."

It will be seen from the above extracts that provision is usually made for redemption by one or more of the following methods:—

- (1) On a specified future date, with an option entitling the company to redeem (either in part or in whole) on or after a stated earlier date.
- (2) For purchase in the market at or below a certain price, either at any time, or on or after a specified date.
- (3) By drawings, either at fixed intervals, or at the company's option, on or after a specified date.

In addition, the redemption may be at a price corresponding with the price of issue, or may be at a higher price, or may vary according to the particular option which the company may exercise.

The object of a company reserving to itself at least two alternatives, either as to date or as to price, or both, is to enable it to choose the most favourable time to redeem the loan, having regard to the state of its own credit and external monetary conditions.

When powers are taken by a company to purchase in the market at or under a specified price, an alternative must always be provided (e.g. drawings at that price), since the market quotation may be in excess of the stipulated maximum.

In the event of a company being able to purchase debentures at a discount for cancellation, such profit may be treated as a revenue profit if the articles do not prohibit this course.

Many issues of debentures are made for the purpose of repaying existing debentures, and in times of low interest rates, this operation results in an economy in interest charges. It is customary in such circumstances to give holders of the debentures to be redeemed the right up to a specified date, to exchange their holdings into the new issue. Such debenture holders are also frequently supplied with special application forms for additional cash applications which will receive priority on allotment.

Companies sometimes provide for the creation of a sinking fund out of which the debentures are to be redeemed. Unless stated to be "out of the profits of the company" such sinking fund is a charge against revenue and must be provided for whether profits are earned or not.

Any amount provided for redemption of debentures must be shown in the profit and loss account (Eighth Schedule, para. 12).

EXCHANGE OF DEBENTURES FOR SHARES.

In isolated instances an option is given to debenture holders to exchange their debentures for shares. The following extracts from two prospectuses offering debenture stock for subscription, are examples of such an option:—

"The Holders of the Debenture Stock now offered will be entitled on the terms and conditions of the undermentioned Trust Deed to convert the Stock held by them at any time whilst it remains outstanding into fully-paid Shares in the capital of the Corporation ranking *pari passu* in all respects with those already issued at the rate of 10 Shares for each £10 nominal Stock. For a period of six calendar months after redemption of the Stock each registered holder at the time of redemption who has not already converted his Stock will have the right to take up, at par, a number of Shares in the capital of the Corporation equal in nominal value to the amount of Debenture Stock standing in his name at the date of redemption. The Trust Deed will provide that no profits or reserves are to be capitalised so long as such rights of conversion and options remain exercisable."

"Any holder of the Debenture Stock of this Issue will have the option, on giving not less than fourteen days' notice to the Company to expire on 31st day of December in any year up to and including 1957, to convert the whole or any part of his holding of Stock, being £5 or a multiple thereof, into Ordinary Shares of the Company at the rate of four fully paid Ordinary Shares of £1 each in exchange for every £5 Debenture Stock in respect of which the Option is exercised. The Stockholder in respect of any Stock so converted will receive interest at the rate of $4\frac{1}{2}$ per cent. per annum up to the

close of the financial year ending 31st December during which he exercises his Option. The Ordinary Shares issued in respect of any such Conversion will entitle the holder to participate in any dividends declared in respect of the next following financial year of the Company and subsequent years. In the event of the Company issuing any further Ordinary Shares (other than by way of conversion) or giving any rights to subscribe for such shares to members of the Company, the holders of any of the £350,000 Debenture Stock then outstanding shall rank for such issue or rights *pari passu* with the holders of the Ordinary Shares then issued and for this purpose £5 nominal of Debenture Stock shall be the equivalent of £4 nominal of Ordinary Share capital.

Provisions of this character give an investor the privilege of coming in with the status of secured creditor and retaining that relationship to the company until such time as profits appear to be sufficiently high to justify changing his status to that of a shareholder. He is thus able to retain the advantage of having his money secured on the assets until the company is in a sound financial position, although it must be realised that once he has elected to exchange his debentures for shares, he has no right subsequently to revert to the capacity of debenture holder.

It is unusual for companies to allow an option of this nature and such provisions are normally only found in the case of those concerns which are unable to show a satisfactory record of profits during the years immediately preceding the issue of debentures.

REGISTRATION OF MORTGAGES AND CHARGES.

Debentures must be registered under the Act. By section 95 every mortgage or charge created by a company:—

- (a) for securing any issue of debentures; *or*
- (b) charged on uncalled capital; *or*
- (c) by an instrument which, if made by an individual, would be a bill of sale; *or*
- (d) which creates a floating charge; *or*
- (e) is a mortgage or charge on land (but excluding a charge for any rent or other periodical sum issuing out of land);
or
- (f) is a charge on book debts; *or*
- (g) charged on calls made but not paid; *or*
- (h) charged on a ship or any share in a ship; *or*

(i) charged on goodwill, patents or copyrights,

shall, so far as it contains a charge, be void against the liquidator and creditors of the company, unless it be delivered for registration with the Registrar within twenty-one days of its creation.

Besides the register kept by the Registrar, the company must:—

- (1) Keep a register of mortgages and charges specifically affecting property of the company and of all floating charges (section 104).
- (2) Keep copies of all mortgages and charges which have to be registered with the Registrar (section 105).

Section 105 also provides that the register and the documents under (2) above shall be open to the inspection of any creditor or member without fee, and the register be available for the inspection of any other person on payment of a fee not exceeding one shilling.

CHAPTER XI

PROFIT AND LOSS ACCOUNT

THE ACCOUNT AS PREPARED FOR INTERNAL USE.

At the end of each financial year the balances of the revenue accounts in the ledger are closed to the profit and loss account, subject to carrying forward any amounts which relate to a subsequent financial period. The necessary adjustments in respect of expenses unpaid, and income not collected at the balance sheet date, will have been made in the ledger prior to opening the profit and loss account, thus ensuring that the whole of the expenditure and income relating to the year are embodied.

It may be relevant at this juncture to remind the reader that the balances remaining in the ledger after the profit and loss account has been prepared are carried down to the succeeding period, and appear, without exception, in the balance sheet. The balance sheet acts therefore as a bridge between one year and another; the only means of carrying a balance from one financial period to the next is over that bridge; that is to say, it must appear in the balance sheet, although, of course, not necessarily as a separate item.

The profit and loss account in the books is usually divided into at least three sections: a trading or manufacturing account, a general profit and loss account, and an appropriation account. If the company's operations embrace both manufacture and selling to the retailer, or direct to consumers, it may include both manufacturing and trading sections, in addition to the remaining two parts. When the business of the company is not that of trading or manufacturing, two sections usually suffice, i.e. a profit and loss account and appropriation account.

The object of the trading account is to determine the *gross* profit derived during the year, i.e. the excess of sales over purchases, after adjusting the values of stock-in-trade at the opening and closing of the year respectively. It is customary to debit to this account, along with purchases, any costs

incurred in acquiring or handling goods, e.g. carriage inwards, storage, dock dues, warehouse wages, etc.

While *gross profit* to a trading company represents the excess of sales over purchases, the term, to a manufacturing company, indicates the excess of sales over the total works or factory cost of manufacture.

A manufacturing account may accordingly contain such expenditure as manufacturing wages, raw materials and carriage thereon, rent, rates, insurance, repairs and depreciation of works or factory, plant, etc.

Alternatively, items which are constant in amount (e.g. rent, rates, depreciation, etc. of factory), are sometimes debited to the general section of the profit and loss account, so as to restrict the manufacturing account to those expenses which vary directly with turnover, as this renders the gross profit figure more useful for comparative purposes between one period and another.

The general section includes on the debit side all current revenue expenditure (whether paid or not) which has not been debited to the trading or manufacturing sections, and, on the credit side, all extraneous receipts such as cash discounts, interest and dividends received, transfer fees, etc. The balance of this account constitutes the *net* profit or loss for the period, and is carried to the last section, i.e. the appropriation account.

In addition to the *net* profit or loss for the year, the appropriation account contains any balance brought forward from the previous year. All allocations of profit disbursed during the year (i.e. dividends, transfers to reserve, amounts written-off goodwill, etc.), are debited. The balance remaining is carried to the balance sheet and shown, grouped with capital and reserves, as part of the aggregate shareholders' interest in the company, a credit balance appearing as an addition and a debit balance as a deduction.

The following is an illustration of a typical trading and profit and loss account and appropriation account as prepared for internal use by a limited company:—

PROFIT AND LOSS ACCOUNT

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TRADING AND PROFIT AND LOSS ACCOUNT, FOR THE YEAR ENDED 31ST MARCH, 1951.

Dr.			Cr.		
	£	s. d.		£	s. d.
To Stock, 1st April, 1950	19,412	6 0	By Sales, less Returns	426,814	4 7
" Purchases, less Returns	372,111	18 1			
	391,524	4 1			
Less Stock, 31st Mar., 1951	22,823	19 10			
" Cost of Goods sold	368,700	4 3			
" Carriage on Purchases	58	1 4			
" Wages	984	12 10			
" BALANCE, being Gross Profit carried down	57,071	6 2			
	£426,814	4 7		£426,814	4 7
To Rent, Rates and Taxes	5,200	0 0	By Gross Profit, brought down	57,071	6 2
" Insurances	48	12 9	" Transfer Fees	197	12 6
" Lighting and Heating	220	8 0	" Dividend on Shares in Subsidiary Company	412	0 0
" Salaries and Office Expenses	3,473	8 1	" Interest on Trade Loans	819	12 6
" Carriage and Delivery Expenses	1,497	12 11	" Interest on Investments other than Trade Investments	1,007	0 0
" Travellers' Commission and Expenses	1,860	17 5	" Profit on Sale of Land	236	8 0
" Bank Charges	138	10 0			
" Sundry Expenses	419	5 2			
" Audit Fee and Legal Expenses	293	9 6			
" Directors' Fees	1,000	0 0			
" Income Tax	3,856	11 7			
" Depreciation	2,429	0 0			
" Debenture Interest	774	0 0			
" BALANCE, being Net Profit for year, carried down	38,532	3 9			
	£59,743	19 2		£59,743	19 2

PROFIT AND LOSS APPROPRIATION ACCOUNT, FOR THE YEAR ENDED 31ST MARCH, 1951.

	£	s. d.		£	s. d.
To Reserve for Debenture Redemption	2,812	8 8	By Net Profit for year, brought down	38,532	3 9
" Reserve for Obsolescence of Assets	300	0 0	" Balance brought forward at 1st April, 1950	18,416	12 9
" Amount written off Goodwill	4,000	0 0			
" Transfer to General Reserve	6,000	0 0			
" Dividend on Preference Shares, June, 1950	4,500	0 0			
" Ditto, December, 1950	4,500	0 0			
" Interim Dividend on Ordinary Shares, October, 1950	6,000	0 0			
" Final Dividend on Ordinary Shares, June, 1951	9,000	0 0			
" BALANCE, carried forward	10,816	7 10			

"CHARGES AGAINST" PROFIT AND APPROPRIATIONS OF PROFIT.

"Charges against" profit are the expenses applicable to the year under review which must be debited against income so that the net profit or loss may be computed accurately. Appropriations of profit are those debits which record the manner in which the profit, or a portion of it, has been allocated in accordance with the directors' proposals, as confirmed by members in general meeting. It is important for accounting purposes that this distinction be rigidly observed.

"Charges against" profits are debited in the trading, manufacturing or general sections of the profit and loss account, and appropriations of profit in the appropriation account.

All "charges against" *must* be debited in the year to which they relate; appropriations of profit are, of course, provisional upon profits being available out of which allocations can be made.

STATUTORY REQUIREMENTS.

Prior to 1948 the law was almost silent on the subject of profit and loss accounts. The 1929 Act merely provided that every company must, not later than eighteen months after incorporation, and subsequently once at least in every calendar year, lay a profit and loss account or an income and expenditure account before the company in general meeting. The first account must cover the period since incorporation, and each subsequent profit and loss account must cover the period since the preceding account, and be made up to a date not earlier than the date of the meeting by more than nine months or, in the case of a company carrying on business or having interests abroad, by more than twelve months. This requirement is now contained in section 148 of the Act.

The section further requires that the profit and loss account shall be made up to the balance sheet date.

Except that directors' fees, including fees received by directors from subsidiary companies, were required to be shown (but not remuneration to a managing director, or to directors in respect of salaried offices), a company was not, until the relevant provisions of the 1948 Act came into operation, under obligation to publish any information showing how the figure of net profit or loss has been computed. The reluctance in those days the legislature to compel the publication of a detailed revenue account was due to an apprehension that disclosure of trade

information to competitive concerns might be dangerous, a conception which has to a large extent disappeared in America and is fast losing ground here.

The provisions of the 1929 Act relating to disclosure of directors' fees offered such obvious scope for easy evasion that a tightening up of the law was inevitable. The tendency up to 1948 for directors to assume some technical, administrative or sales designation became pronounced and the practice entirely defeated the object of the 1929 Act. These provisions are repealed by the Act of 1948 and the new requirements are set out in this chapter.

Profit and loss accounts published by companies prior to 1948 were accordingly normally presented to shareholders in condensed form and disclosed little or no information as to how the profit or loss had been arrived at.

Legislation up to the second world war tacitly assumed that shareholders and creditors are the only persons interested in the accounts of companies, but a change of social outlook has brought about a tendency to regard employees as having some moral right to information as to the financial results of their services and how the profits, to which they have contributed by their efforts, are utilised.

The Cohen Committee considered "*that the profit and loss account is as important as, if not more important than, the balance sheet, since the trend of profits is the best indication of the prosperity of the company and the value of the assets depends largely on the maintenance of the business as a going concern.*" The American Institute of Accountants has said "A fair determination of income over successive accounting periods is the most important single purpose of the general accounting reports of a corporation."

The Act accordingly breaks new legislative ground in requiring that the profit and loss account (or income and expenditure account, when it is so called) shall be as informative as the balance sheet. The Act lays down certain minimum requirements as to the contents of the profit and loss account calculated to ensure that it gives a fair indication of the earnings during the period to which it relates.

The profit and loss account is now required to be drawn up in accordance with accepted accountancy principles *consistently maintained* and if, for any reason, a change of a material nature (e.g. a change in the basis of stock valuation)

is adopted, specific attention must be called to the change and to the effect thereof.

While the general provisions relating to profit and loss accounts—like those relating to balance sheets—are contained in the Act itself, the detailed contents of these important documents appear in the Eighth Schedule. As will be observed by reference to Appendix A the same method is adopted with group accounts. The provisions of the Schedule are capable of being modified or extended by statutory order approved by affirmative resolution of Parliament as distinct from amending legislation. The object of such legislative flexibility is to obviate hampering progress in the technique of conveying information through published accounts. A number of obligations imposed upon companies are laid down in this way so that they can, if necessary, be altered without all the formalities of an amending Act. Section 454 contains a safeguard in this connection to the effect that no such alterations shall make the requirements of the Act relating to accounts more onerous *“unless a draft of the instrument containing the regulations has been laid before Parliament and has been approved by resolution of each House of Parliament.”*

Section 149 gives the Board of Trade power on the application or with the consent of a company's directors, to modify any of the requirements of the Act relating to the balance sheet or profit and loss account *for the purpose of adapting them to the circumstances of the company.*

The elasticity of the Act so far as its accounting provisions are concerned is one of its most commendable characteristics. While a full disclosure of essential information is required, the preparation of a company's accounts has not been relegated to the process of “filling-up forms” and it is hoped that state of affairs will never be reached.

It is emphasised that the overriding requirement of the Act relating to the profit and loss account (contained in section 149), *is incapable of modification by the Board of Trade and applies without prejudice to any other requirements of the Act.* This overriding requirement is that the account—

“shall give a true and fair view of the profit or loss of the company for the financial year.”

In addition, therefore, to compliance with the many new requirements of the Act (as referred to on succeeding pages)

it is essential, when preparing a profit and loss account, to include everything which is consistent with the disclosure of "a true and fair view" and, conversely, to exclude anything which may distort that view.

We will now consider in detail the new legal obligations in regard to profit and loss accounts.

Without prejudice to the generality of the foregoing overriding requirement, the profit and loss account is required by the Eighth Schedule to include the following information:—

1. *The amount of profit or loss, or net income or net expenditure, before charging or crediting the items enumerated in (2) to (14) which follow.*

Perhaps one of the strongest criticisms of the Act is that it has created an opening figure on the credit side of the profit and loss account which in nearly all cases is entirely meaningless. It merely represents the gross turnover to which all other sources of income which are not required to be disclosed have been added and from which all expenses which are not required to be shown separately have been deducted. In other words it is the net profit before items (2) to (14) which follow have been credited or charged.

This practice has the effect of concealing the turnover for the year and, while a few prominent companies in this country do publish this significant figure, the general reluctance to disclose to competitors the volume of business effected still prevails. In America it is the rule rather than the exception to publish figures of turnover and the Securities and Exchange Commission require this from all companies as one of the conditions of obtaining quotations on the stock exchanges. It is probable that if the practice was made compulsory in this country any disadvantage suffered by revealing information to competitors would be compensated by the benefits derived in the processes of long-term planning from having available the turnover (in conjunction with figures normally published) of other companies.

The indirect disclosure of turnover in statements of turnover analysis is referred to on page 239.

2. *Provision for depreciation or renewals of fixed assets (para. 12).*

If provision is not made by means of a depreciation or renewals charge, the method of making such provision must be

indicated. If no provision for depreciation or renewal has been made *the fact must be stated* (para. 14). This requirement will strengthen the hands of auditors who are not satisfied that adequate depreciation is being provided. Provisions for diminution in value of assets must not exceed such amounts as, in the opinion of the directors, are reasonably required for the purpose; any excess is required to be treated as a *reserve*, not as a provision (para. 27).

It has been the practice of some companies in the past to make liberal allocations for depreciation, etc., in prosperous years, so that less successful years could be relieved of some of this burden. Although such a policy may have been pursued with the best intentions and in the interests of the company as a whole, accountancy principles have not recognised it. Expedients to equalise net revenue are available, as described elsewhere in this book. It is now obligatory to disclose such adjustments by treating them as free reserves. The Act therefore brings the law into line with accepted accountancy principles.

The treatment of excess depreciation provided or written-off prior to 1948 is discussed in Chapter III.

Where assets are depreciated on a revaluation basis each year (as often happens in the case of loose-tools, casks, bottles, patterns, jigs, etc.) it would seem that any appreciation should conversely be reflected as a credit in the profit and loss account, although the provisions of the Act do not cover this point.

Amounts provided over and above the normal provision for depreciation, so as to set aside profits to meet enhanced costs of replacements, should be separately shown in the appropriation section of the account and preferably treated as transfers to capital reserve (see page 258).

3. *Interest on debentures and other fixed loans* (para. 12).

It would seem desirable that this item should also indicate whether interest is shown *gross* or *net* (i.e. before or after deduction of income tax). In this connection it is worthy of note that the Institute has recommended that annual charges for debenture and other interest, royalties and similar annual payments should be charged *gross*. A company acts merely in the capacity of "tax-gatherer" in respect of such payments, deducting tax at the source (for ultimate remittance to the Inland Revenue), the incidence of the tax falling, of course,

on the recipients of the interest, etc. Such tax is therefore NOT a charge in the company's accounts and by showing the interest paid at the gross amount, the resultant credit to income tax account offsets payment in discharge of the tax.

4. *The amount of United Kingdom taxation on profits* (paras. 12 and 14).

This figure is required by para. 12 to be sub-divided, where practicable, into (a) income tax and (b) any other tax which may be assessed on profits, this now being confined to profits tax. This requirement will ensure disclosure of the extent to which the Inland Revenue on the one hand and shareholders on the other have participated in profits.

The Act does not give any indication as to how the figure for taxation shall be computed, except that the basis for income tax must be disclosed (para. 14) and any taxation imposed elsewhere to the extent of the relief from United Kingdom income tax must be included (para. 12). It has already been mentioned that interest on debentures, loans and other annual charges may advantageously appear gross in the annual accounts so that credit for the amount of tax extraneous to a company's liability for tax on its profits shall appear in the income tax account. By contrast, tax deducted from dividends represents part or whole of the tax computed on a company's profits, the incidence of which is passed on to shareholders who participate in those profits. It is advocated therefore that no credit should appear in the income tax account in respect of deductions from dividends, the dividends (as will be stated later in this chapter) being shown *net* in the profit and loss account.

These suggestions (which have been officially endorsed by the Institute of Chartered Accountants) are made so that the figure for income tax appearing in the profit and loss account shall represent the true liability of the company.

To attain this object it is also necessary to show all revenue *taxed before receipt* (e.g. interest on investments, ground rents, royalties, etc., received) *gross* in the profit and loss account, a journal entry being made in the books debiting income tax account and crediting the appropriate revenue account with the amount of tax deducted.

Adjustments are necessary for outstanding interest, rents, etc., both receivable and payable, so that the *gross* amounts

outstanding are reflected in the profit and loss account, the income tax thereon in the income tax account and the *net* amounts outstanding appear in the balance sheet.

The wording of para. 12 (c) (see page 340) needs some amendment. *Taxation imposed elsewhere* (i.e. dominion and foreign taxation) *to the extent of the relief, if any, from United Kingdom income tax* is required to be included, *where practicable, as United Kingdom income tax*. The object of this requirement is quite clear, the intention being to ensure that the taxation figure is not distorted when relief under the various reciprocal arrangements between countries is taken advantage of. The word "as" after "practicable," however, would be better altered to "with" and "taxation" is to be preferred to "income tax" so as to include profits tax.

The application of this sub-paragraph is exemplified by assuming that in 1951 a company has suffered foreign income tax to the amount of £68,000, of which £27,000 is allowable against profits tax for 1951 and £24,000 against income tax for 1952/53, the balance of £17,000 not being eligible for any relief. If the estimated liability for profits tax in 1951 is £7,000 (i.e. £34,000 less the relief of £27,000) and the estimated liability for income tax for 1952/53 is £14,000 (i.e. £38,000 less the relief of £24,000), the charge in the profit and loss account for United Kingdom profits tax would be £34,000 and for United Kingdom income tax, £38,000. The account need not disclose the foreign income tax not available for relief (i.e. £17,000), which may be deducted in arriving at the opening balance of trading profit brought in.

The requirement that the basis of arriving at the charge for income tax must be shown necessitates a statement indicating whether income tax has been charged on profits *earned* to the date of the balance sheet or is merely the legal liability on profits *assessed* to that date (or any intermediate compromise which may have been adopted). These alternative treatments are fully discussed on pages 140 to 149 and the advantages of the former policy, now widely adopted, are referred to on those pages.

It will not always be easy for a company immediately to follow this prudent advice, particularly during the first years of its existence or when it has been the practice to make provision for only the legal liability. For example, a company which commences business on 6th April will be assessed

twice for income tax on its profits for the first year: once for the fiscal year coinciding with the first year of business and again, for the following fiscal year. The company would need to provide for double taxation in the one year which may, to say the least, be very inconvenient.

The difficulty may be overcome if a company can set aside four years' tax out of the first three years' profits (this being the normal period during which reliefs for new businesses apply). When it is not possible to set aside the full amount for future taxation, the balance sheet designation might appropriately be "Reserve towards Future Income Tax" or "Reserve for part of Income Tax, 1952/53."

Another difficulty in strictly adhering to this recommendation arises when, at the time of making up a company's accounts, the rate of tax chargeable for the fiscal year in which the profits will be assessed is not known. In such circumstances, of course, the liability for income tax should be estimated.

As already stated, the Act does not prescribe how the charge for income tax shall be computed, but the basis adopted *must be disclosed*.

5. *Amounts provided for the redemption of (a) share capital and (b) loan capital* (para. 12).

This, of course, refers to amounts set aside for the redemption out of profits of redeemable preference shares (see pages 118-122) and the redemption of debentures and other loans. The word "provided" used in paragraph 12 (a) is an unfortunate term since amounts set aside to redeem preference shares are appropriations to reserve and NOT provisions.

6. *The amount, if material, set aside to reserves* (para. 12).

7. *The amount, if material, set aside as provisions* (para 12).

This refers to the total amount set aside as provision for specific liabilities, contingencies or commitments known to exist at the date of the balance sheet other than provisions for depreciation of assets. It is provided that the amounts retained as provisions and charged in the profit and loss account shall not exceed such amounts as, in the opinion of the directors, are reasonably required for the purpose (para. 27). The effect of this requirement on secret reserves and some interesting exemptions from the obligation are discussed on pages 153 and 154.

The Board of Trade may direct that the amount set aside to provisions need not be shown separately if the Board is satisfied that disclosure is *not required in the public interest and would prejudice the company*, subject to the condition that any heading embodying a provision shall be so framed or marked (para. 12).

8. *Auditors' remuneration, including expenses* (para. 13).

This is required to be shown separately in the profit and loss account only when it is NOT fixed by the company in general meeting (see page 211).

9. *Income from trade investments* (para. 12).

10. *Income from investments, other than trade investments* (para. 12).

As already mentioned, it is desirable that all income from investments, etc., should appear in the profit and loss account *gross*, i.e. by "adding-back" any tax deducted before receipt (and, of course, debiting income tax account with a corresponding amount).

Difficulty may arise in some companies in determining whether a particular investment is a "trade investment" or not and the suggestion given on page 67 may be of some assistance in this connection.

11. *The aggregate, if material, of amounts withdrawn from reserves* (para. 12).

12. *The aggregate, if material, of amounts withdrawn from provisions* (para. 12).

Provisions are, of course, normally employed to meet the liabilities for which they have been set aside. When, however, a provision, or any part thereof, is not required for its specific purpose and is transferred to revenue, the resultant credit in the profit and loss account must be disclosed.

It will accordingly be seen that a company is required to show *as separate items* in the account transfers TO *both* reserves and provisions and also transfers FROM *both* reserves and provisions. The Act requires for the first time the segregation of reserves and provisions, a matter which is discussed in Chapter IX.

In regard to (11) and (12) above, it is assumed that the requirements of the Eighth Schedule apply only to such

movements of reserves and provisions as are charged or credited to revenue and do not necessarily require the passage through the profit and loss account of additions to or withdrawals from reserves and provisions which would not normally be passed through that account (e.g. a transfer from revenue reserves to capital reserves).

13. *Profits or losses of a non-recurrent or exceptional nature, if material in amount and any change in the basis of accounting (para. 14).*

Any exceptional or isolated items must be shown separately and also any item affected by a transaction of a sort not usually undertaken by the company (unless the sums involved are negligible in amount). Although the Act does not define non-recurrent or exceptional items, the proposal will add considerably to the value of profit and loss accounts when used for comparative purposes either as between one year and another or as between one concern and another. If any material change is made in the basis on which the account or any item therein is calculated, *attention should be called to the change and to the effect thereof by way of note on the account.*

There is little guidance in the Act as to what may be regarded as "*material in amount*" and the Cohen Report avoided any suggestions, but the Institute has advocated that this is a matter within the discretion of the directors subject to the auditors reporting if they take a view which differs from that of the directors. Section 157 contains the words "*so far as is material for the appreciation of the state of the company's affairs by its members*" and although this would seem to apply to section 157 only, it may imply a more general application in the absence of any other indication. (The American interpretation of "*an insignificant amount*" in relation to group accounts is referred to on page 74.)

Some of the foregoing items may be stated by way of note, if not otherwise shown.

14. *The aggregate amount of dividends paid and proposed, disclosing whether or not the amount stated is for dividends subject to deduction of income tax (paras. 12 and 14).*

It has already been advocated in this chapter that dividends should be shown *net* (i.e. *after* deduction of tax) for the reason stated and this applies irrespective of whether dividends are

declared "less tax" in the usual manner or "free of tax." The option to declare dividends "less tax" or "free of tax" will however, still remain with the company.

Although dividends paid and *proposed* are required to be shown in the profit and loss account—and there is a great deal to be said in favour of embodying details of the appropriation of profit in the accounts of the year in which that profit has been earned or accumulated—it is doubtful whether the practice can be justified on academic grounds. The proposals of the directors for the appropriation of profit can, of course, only be made after the accounts have been closed. Such proposals cannot be given effect to until they are ratified by shareholders at the annual general meeting which takes place sometime during the *succeeding* financial period. It would seem, in a sense, presumptuous on the part of directors to submit to shareholders a profit and loss account and balance sheet containing proposals for which they seek approval at the meeting, a notice convening which accompanies the accounts. The situation will be embarrassing in those rare instances when shareholders do not approve the directors' proposals at the general meeting.

It is appreciated, of course, that the passing of the resolution for the appropriation of profits is normally a formality at the general meeting and the practical advantages of showing the appropriations in the accounts of the current year outweigh the theoretical objection and the difficulties which might arise in isolated cases.

A commendable practice adopted by some companies is to show the profit appropriations in the profit and loss account and balance sheet in distinctive type, e.g. *italics* (see example on pages 350, 352 and 354), so as to indicate those items which are subject to the approval of the shareholders. This overcomes to a considerable extent the academic objection.

It is provided that the *net* aggregate amount of any dividend recommended by the directors should be shown in the balance sheet (para. 8).

DIRECTORS' EMOLUMENTS.

There must be disclosed in the accounts or in a statement annexed thereto the aggregate amount of directors' emoluments (section 196).

This figure is required to include all emoluments, whether received from the company, its subsidiaries or any other person. The amount must distinguish between sums received as a director (either of the company or its subsidiaries) and other emoluments, e.g. salaried position(s) held with the company or its subsidiaries.

The foregoing amounts are required to include such expenses as are charged for United Kingdom income tax (i.e. generally other than out-of-pocket expenses), any contributions paid in respect of directors under any pension scheme and the estimated value of any benefits received otherwise than in cash. As the estimated value of any benefits received otherwise than in cash have been brought within the orbit of taxation (Finance Act, 1948) it would seem that the latter might also be restricted to *taxable benefits*.

Prior to the operation of the Act, the compulsory disclosure of directors' fees was the only statutory requirement in regard to the contents of the profit and loss account. The 1929 Act, however, made an exclusion in the case of fees paid to directors *holding salaried appointments*. Many readers will recollect that, as mentioned earlier in this chapter, a large number of directors assumed executive and technical titles after the passing of the Act, so that the requirement as to disclosure could be avoided!

An unsuccessful attempt was made to have embodied in the 1947 Act a requirement that the emoluments of *individual* directors should be disclosed.

The weakness in this proposal lay in the fact that shareholders and others are not able to assess the value of an individual director's services without full information as to the extent of his duties and responsibilities, whereas the value of the services of the board as a body can broadly be gauged from activities and results of the company as a whole.

There are some who advocate that the remuneration of officers other than directors in receipt of a salary of not less than a specified amount should be disclosed. This contention was put to the Cohen Committee which rejected the suggestion on the grounds that an important distinction exists between directors and executives other than directors. The latter are under the control of the board, which controls their activities and fixes their remuneration, while the remuneration of directors is (subject to the Articles) fixed by themselves.

DIRECTORS' PENSIONS.

Section 196 requires similar disclosure of the aggregate amount of directors' or past-directors' pensions and the amount must include pensions received from the company, or its subsidiaries or any other person (e.g., a person who has obtained a controlling interest in the company).

Benefits received by directors and past-directors from a contributory pension scheme when the contributions are substantially adequate to maintain the scheme may be excluded from the sum disclosed. The reason for this exclusion is that the *contributions* now fall to be disclosed as emoluments under the same section, as stated on the previous page.

COMPENSATION PAID TO DIRECTORS.

The same section requires the aggregate amount of compensation paid to directors or past directors for loss of office to be shown in the accounts or in a statement annexed thereto.

Again, the amount must include sums paid by the company, its subsidiaries or any other person. Cases have arisen in the past where the manner of making compensation payments to directors has been open to invidious comment, e.g., where a contract is entered into with a managing director with the specific intention of terminating the contract and paying compensation in the form of capital and not of income.

The new requirement as to disclosure will act as a deterrent to this and other questionable practices, and it brings the law into line with the provisions relating to directors' emoluments and pensions, referred to in previous paragraphs.

Section 198 places an obligation upon directors to give notice to the company of emoluments, pensions and compensation but there is no compulsion for this to be *in writing* as is required for other information referred to in the section. Suggestions have emanated from several quarters that this apparent anomaly should be remedied in the interests of auditors and other officers of companies.

PROHIBITION OF TAX-FREE PAYMENTS TO DIRECTORS.

Payments of remuneration to directors *free of tax* are not now lawful (section 189). The objections to the practice (which has not been uncommon in the past) are that it created a class of person immune from tax increases and where payment is made free of sur-tax, the true remuneration cannot be

determined without knowledge of the director's total income for the year.

CORRESPONDING FIGURES FOR PREVIOUS YEAR.

A convenience which will be welcomed by all who have to peruse profit and loss accounts is the proposal that *corresponding figures for the immediately preceding financial year* must be shown (see page 17).

Some exceptions to the requirements of the Act as set out in this chapter, are enjoyed by banking, discount and assurance companies and companies of any class prescribed by the Board of Trade in the national interest* may be exempted from the requirements relating to reserves and provisions (including provisions for depreciation and renewals). This exemption is subject to any conditions which may be imposed as to matters to be stated in the accounts or by way of note and as respects information to be furnished to the Board (para. 25).

THE PROFIT AND LOSS ACCOUNT FOR PUBLICATION.

The reader will have noticed that the items which are required to be shown in the profit and loss account include both *charges against* and *appropriations of* profit. An excellent method of presentation is to divide the published profit and loss account into at least two sections, the first including charges against income (e.g. income tax, debenture interest, depreciation, etc.), and the second, appropriations of profits (i.e. dividends, transfers to and from reserve, etc.). This avoids confusion on the part of the uninitiated who are otherwise liable to be misled into assuming that items such as debenture interest, provisions for depreciation, etc., are conditional upon profit being adequate to permit of these charges being made. Quite apart from this consideration, to divide the published profit and loss account into at least two sections (the balance of the first representing the net profit derived or loss sustained during the period covered by the account, and the second, showing the appropriation of that profit, together with the balance of unappropriated profit, or conversely, accumulated loss, brought forward) is both logical and in accordance with best accounting principle.

* Shipping companies were added to this list in 1948 (see page 153).

PROFIT AND LOSS ACCOUNT, FOR THE YEAR ENDED 31ST MARCH, 1951.

1949-50.		1949-50.	
£	£	£	£
105	To Auditors' Fees (as agreed between Directors and Auditors)	105	By Net Trading Profit, after providing or Management Remuneration,
3,477	" Income Tax (including Reserve for Tax on Profits earned to 31st	39,978	Administrative and other charges
1,000	March, 1951)	102	" Transfer Fees
2,040	" Directors' Fees	1,236	" Dividend Received on Shares in Subsidiary Company (Gross) ..
774	" Provision for Depreciation of Fixed Assets	861	" Interest Received (Gross):—
36,612	" Debenture Interest (Gross), including Interest provided to 31st March,	2,431	On Trade Loans
	1951		On Investments other than Trade Investments
	" Balance, being NET PROFIT, carried down		" Non-recurring profit—
			Sale of Land
<u>£44,008</u>		<u>£44,008</u>	<u>£46,697</u>

PROFIT AND LOSS APPROPRIATION ACCOUNT, FOR THE YEAR ENDED 31ST MARCH, 1951.

1949-50.		1949-50.	
£	£	£	£
4,500	To Dividends on 6% Preference Shares (net)	4,500	19,863 By Balance brought forward at 1st April, 1950
4,500	30th June, 1950	4,500	36,612 " Net Profit, brought down
6,000	31st December, 1950		
	Interim Dividend at the rate of 4% on Ordinary Shares, 1st October,		
	1950 (net)	6,000	
	To Appropriations as per Recommendations of Board of Directors to be		
	submitted to the Annual General Meeting of Members on 10th June,		
	1951:—		
	Transfers to Reserves for:—		
2,883	Debenture Redemption	2,813	
175	Obsolescence of Assets	300	
5,000	Amount written off Goodwill	4,000	
6,000	Transfer to General Reserve	6,000	
	Final Dividend at the rate of 6% on Ordinary Shares to be paid on		
9,000	12th June, 1951 (net)	9,000	
18,417	Balance, carried forward	19,836	
<u>£56,475</u>		<u>£56,475</u>	<u>£56,949</u>

In the light of the requirements of the new Act, the profit and loss account reproduced on page 173. has accordingly been re-drafted for filing and publication in the form illustrated on the opposite page, the modern and commendable practice of omitting shillings and pence being adopted.

SOME CRITICISMS OF PRESENT-DAY PROFIT AND LOSS ACCOUNTS.

As the provisions of the Act relating to profit and loss accounts are almost entirely new, it is perhaps not surprising that accountants have in general experienced more difficulty in achieving the requisite "true and fair view" in the profit and loss account than in the balance sheet. An inspection of the accounts of a number of companies invariably reveals divergencies of practice in computing a "true" net profit or loss for the year. It is usually necessary to take pencil and paper and make a few calculations from the revenue figures of each company in order to arrive at a net profit or loss which is effective for comparative purposes.

Some companies strike a balance representing the net result of operations before charging taxation, while others show the debit for taxation afterwards. In some profit and loss accounts extraneous and non-recurrent expenses and income are included in arriving at the net revenue for the year and in other accounts these amounts are charged or credited "below the line." Again, such items as debenture interest, directors' fees, etc., vary in their location in the profit and loss account, thus giving rise to inconsistencies in the conception of profit.

The layman may be forgiven for asking the natural question, "What are profits?" The accountant can think of a dozen answers—all different and each finding some acceptance in commercial practice, while the Inland Revenue rejects them all and employs less realistic concepts in the assessment of income for taxation purposes!

However inevitable this unpalatable state of affairs may be, there are clearly grounds for concern if even the accountant has to resort to pencil and paper calculations before he can determine the true result of a company's operations on a basis which can be consistently applied for all companies.

While it is unwise to dogmatise in advance of standard practices taking shape, there would seem to be a great deal to be said in favour of sub-dividing into two sections what has

on previous pages been referred to as the first section of the profit and loss account, the first to close with a balance which represents the net profit or loss on the year's *normal operations, after charging taxation attributable to those operations.*

The next section can then accommodate any debits or credits of an abnormal or extraneous character (e.g. profits or losses on sales of fixed assets, heavy claims not covered by insurance, bad debts of appreciable dimensions unexpectedly recovered, etc.), also taxation reliefs or liabilities relating to such items and any other taxation not attributable to normal revenue for the year, examples of which are referred to on other pages.

This lay-out enables the net result of the year's operations, after charging taxation thereon, to be revealed, all debits and credits not appertaining to the normal or current conduct of the business appearing below, before arriving at the balance carried to the appropriation section.

INCORPORATION OF PROFIT AND LOSS FIGURES IN DIRECTORS' REPORT.

It is the practice of a few companies to incorporate the profit and loss figures in the directors' report as an alternative to publishing a separate profit and loss account. The example reproduced is taken from the 1951 accounts of Industrial and Commercial Finance Corporation, Ltd., which on 31st March, 1951, had issued and called-up £20,000,000 of its authorised share and loan capital of £45,000,000:—

REPORT OF THE DIRECTORS

The Directors submit their report for the year to 31st March, 1951, together with the audited Balance Sheet at that date and the following Statement of Profit and Loss.

Statement of Profit and Loss

<i>Year to</i> 31st March, 1950		<i>Year to</i> 31st March, 1951
£		£
536,161	Interest on Advances, and Dividends received from Investments, less Interest on Loan Capital, amount, before deduction of Income Tax, to	714,830
	<i>Note.</i> —Dividends received attributable to periods prior to the date of acquisition of the relevant holdings have, where appropriate, been set off against the cost of such holdings and in consequence are not included in the above total.	
	To which has to be added Other Income (including Net Profits on Sales of Investments) amounting to	137,981
<u>128,053</u>		
664,214		852,811

PROFIT AND LOSS ACCOUNT

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There fall to be deducted:—	
106,025	Administration Expenses 110,541
Directors' Remuneration:—	
4,000	Fees 4,000
2,500	Salary 2,500
	6,500
630	Provision for Audit Fee 787
Depreciation and Amortisation:—	
Amounts written off Freehold and Leasehold Property, Furniture and Equipment	
429	4,318
113,584	122,146
and	
Amount set aside for Doubtful Advances and Investments 150,000	
303,584	272,146
So that the Profit for the Year before taxation is 580,665	
360,630	
The estimated charge for Income Tax based on the profit for the year is 219,468	
126,226	
234,404	361,197
Leaving a Net Profit for the year of	
To which has to be added the Surplus brought forward from the previous period of .. 80,819	
53,585 (Deficiency)	
180,819	442,016
Resulting in a balance to the Credit of Profit and Loss Account of	
100,000	400,000
The Directors have decided to make a further transfer to Reserve for Contingencies of ..	
£80,819	£42,016
So that there is a Surplus on the Profit and Loss Account to be carried forward of ..	

Under the Articles of Association The Rt. Hon. Lord Blackford, Mr. Reginald Hugh Roberts and Mr. Colin Marshall Skinner retire from the Board and, being eligible, offer themselves for re-election.

Messrs. Whinney, Smith & Whinney have expressed their willingness to continue in office as auditors.

By Order of the Board,
 GILBERT SEYMOUR STONE,
Secretary.

Registered Office:
 7, DRAPERS' GARDENS,
 LONDON, E.C.2.

8th May, 1951.

SIGNATURE, AUDIT AND CIRCULATION OF PROFIT AND LOSS ACCOUNT.

The Act requires that the profit and loss account shall be annexed to the balance sheet and approved by the board of directors before the balance sheet is signed on their behalf (section 156) and also that the auditors' report must cover the profit and loss account as well as the balance sheet (section 162).

Section 148 requires that a profit and loss account (made up to the date of the balance sheet) shall be laid before the company in general meeting not later than eighteen months after incorporation and thereafter once at least in every calendar year. The exception in the case of holding companies (section 149) is commented upon in the chapter on Holding Companies and Group Accounts (page 83).

The profit and loss account, together with the balance sheet and documents required to be annexed thereto must, subject to the exceptions set out in section 158, be circulated to shareholders and *debenture-holders* not less than *twenty-one* days before the general meeting. This applies to *both* public and private companies.

PROFITS AND LOSSES OF SUBSIDIARY COMPANIES.

The unsatisfactory state of affairs until 1948 relating to the incorporation of profits and losses of subsidiaries in the profit and loss account of the parent company is referred to in Chapter VI (pages 69-71). As stated in that chapter, it is provided by the Act that a holding company must, subject to the qualifications mentioned, publish *group accounts* (made up to the date of the balance sheet of the holding company, if possible). The requirements of the Act relating to profit and loss accounts generally apply to consolidated profit and loss accounts.

DIRECTORS' PROPOSALS AS TO ALLOCATION OF PROFITS, ETC.

It is compulsory for a company to attach to every balance sheet a report by the directors with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid by way of dividend, and the amount, if any, which they propose to carry to reserve, etc. (section 157).

Examples of annual reports will be found on pages 356, 368 and 392.

The section also requires the directors' report to deal with any change in the nature of the company's business or in the subsidiaries or in the classes of business in which the company

has an interest (whether as a member of another company or otherwise) provided that such information will not, in the directors' opinion, be harmful to the business of the company or its subsidiaries. Section 127 requires a copy of the report to be included in the annual return—except in the case of an exempt private company (section 129), and as stated in the next paragraph.

Directors' reports are often quite uninformative and confined to the bare bones of the requirements of section 157. Some interesting exceptions and a number of progressive practices adopted by American companies are discussed in Chapter XIV. Widespread misapprehension has arisen out of an apparent conflict between the provisions of sections 157, 158 and 163. Section 157 has already been referred to; section 158 provides for the circulation of accounts, *including every document required by law to be annexed thereto*, but section 163 provides that reference to a document required to be annexed shall *not* include the directors' report. From a letter to the author from the Board of Trade, in answer to an enquiry, it would appear, in the absence of any interpretation to the contrary by the Courts, that the report need not be issued with the balance sheet *except when it contains information which the Act allows to be given in the report instead of in the accounts*.

This official opinion will be of especial interest to secretaries and accountants of private and small public companies.

It is not difficult to envisage that when the law relating to companies is again amended the directors' report will be made a much more informative document than it often is at present. It is interesting to observe in this connection that the Millin Commission in South Africa recommended the following information, additional to that required in our Act, for inclusion:—

- (a) Any fact or circumstance which has occurred *since the date of* the balance sheet and is material to an appreciation of the state of the company's affairs.
- (b) Any changes in the directorate of the company or its subsidiaries.
- (c) Particulars of any allotments during the period, other than those made in pursuance of an offer for subscription to the public or to existing holders in proportion to their holdings or allotments specifically authorised by the company in general meeting.

- (d) Material particulars of contracts made for the employment of any person as managing director or manager of the company.

The Commission recommended that "*the report should be used as a means of apprising members of the very latest developments.*"

It has already been mentioned that the recommendations of directors for the allocation of profits need to be ratified by members at the general meeting of the company, and dividends become a debt due to shareholders as from the date of the meeting (not from the date of the balance sheet nor the date of the report).

Due attention must be paid to the dividend rights of each class of shares, so that preferred dividend rights attaching to certain classes are not disregarded when deferred dividends are proposed.

Holders of preference shares cannot compel the company to declare preference dividends merely because profits are adequate to defray the distribution. In *Bond v. Barrow Haematite Steel Co.* (1902), the learned judge said the Court would be very reluctant to compel directors to divide more than they thought proper. The claims of preference shareholders to dividends are, therefore, subject to the directors' right to carry sums to reserve, etc. But directors must act fairly in the interests of *all* classes of shareholders. Similarly, profits must not be divided up to the hilt by the payment of excessive dividends on deferred shares at the expense of neglecting to make proper provision for contingencies, thereby endangering the security of preference shareholders.

In the case of *Stewart v. Sashalite, Ltd.* (1936), a company agreed to pay to a promoter a sum out of "its first profits and in priority to all dividends." In the opinion of Mr. Justice Branson, the directors were not under any duty to pay the said sum before making due provision for preliminary expenses and reserve.

A subsequent case (*Drown v. Gaumont British Picture Corporation, Limited* [1937]), referred to the payment of a preference dividend in a year when a loss had been incurred. There had been a loss of £780,000 for the year 1936-37. Against this loss there were available two sums of £362,000 and £500,000. The former sum consisted of profits available for

dividend. The £500,000 was made up in part of premiums on the issue of shares and in part of profits which had been carried to reserve, and invested in the assets of the company.

An injunction was sought to restrain the company from paying a dividend on its preference shares.

Mr. Justice Clauson held that (1) the onus was upon D. to establish that in paying such dividend the company would trench upon assets of the company representing capital paid up on the shares; (2) the assets of the company should be properly valued and should be treated as notionally divisible into two parts, one part representing subscribed capital and the other part representing reserve. These two parts should be proportionately reduced in respect of any diminution of value and the reserve so reduced should be available for dividend; (3) such part of the reserve fund as consists of moneys paid by way of premiums on shares would be available for purposes of dividend, unless such part of the reserve fund had been set aside in some particular fund which had been wholly spent.

The Act now, of course, precludes share premiums from being applied in this manner (see page 126).

In the more recent case of *Buenos Ayres Great Southern Railway Co., Ltd. v. Preston and Another* (1947), the company had been incurring losses for some years and at 30th June, 1944, there was a debit balance of £1,836,538. In the following year the company made profits which enabled the debit balance to be slightly reduced and the directors were of the opinion that it would be improvident to recommend payment of any dividend. The preference stocks were entitled to a dividend up to 5 per cent. per annum *out of the profits of the company for each year* but deficiencies were not to be cumulative. By Article 29 of the company, however, it was provided that "the Board are hereby authorised to increase the reserve fund from time to time to such amount as they shall think fit, and for that purpose to carry to such fund for each year such part of the undivided profits of the company from whatever source arising as they may think fit."

It was decided that the fixed dividends for each year were payable only out of such part, if any, of the profits of each year as might be remaining and available for dividend after setting aside to reserve or carrying forward in the accounts such amounts as the directors of the company might think proper.

A commendable practice in company finance is to "plough-back" profits into the undertaking, by financing extensions, etc., out of profits which might otherwise have gone to swell the income of ordinary and deferred shareholders. Many companies whose names are household words to-day owe, to a considerable extent, their present influence and financial strength to this process of building up the business out of profits. A certain measure of "ploughing-back" has been inevitable in recent years due to the voluntary restraint on dividends, a post-war political development which is discussed at some length in Chapter XV.

DIVIDENDS.

A dividend is the division of the profits of a company. When properly declared in general meeting a dividend becomes a debt due to shareholders, and being a *speciality* debt, it is recoverable against the company any time within twelve years. Unclaimed dividends should not, therefore, be transferred to the profit and loss account until the full period has elapsed.

A company is empowered to deduct income tax from dividends at the full standard rate in force at the date of declaration of the dividends. Unless, therefore, expressed to be "free of tax," dividends are paid net, i.e. after deduction of tax. Thus, when the standard rate of tax is 9s. 6d., a dividend of ten per cent. on capital amounting to £100 would be calculated as under:—

	£	s.	d.
Dividend of 10 per cent. on £100 ..	10	0	0
Less Tax at 9/6	4	15	0
Net amount payable ..	<u>£5</u>	<u>5</u>	<u>0</u>

"FREE OF TAX" DIVIDENDS AND INCOME TAX.

When dividends are stated to be "free of tax," the net amount of dividends is expressed as a percentage instead of the gross amount. A dividend of $5\frac{1}{2}$ per cent. "free of tax" on £100 would accordingly be equivalent to £5 5s. 0d., and if the rate of tax be 9s. 6d., this income would be the same *in every respect* as the 10 per cent. dividend calculated above.

A company does not have to account directly to the revenue for tax deducted from dividends. It pays tax on profits earned, as adjusted for income tax purposes, and recoups

tax from shareholders on that portion distributed as dividends. It will be seen that the expression "free of tax" is somewhat misleading, and might cause some erroneously to infer that the income in question is, for some reason, not subject to tax.

Shareholders who are not liable for income tax, and those liable at less than the full standard rate should see that "free of tax" dividends are "grossed-up" in calculating the amount of tax deducted from the income at the source. In the foregoing example the process of working would be as under:—

$$\begin{array}{rcl} £5 \text{ 5s. od.} \times \frac{40}{31} & = & £10 \text{ 0 0} \\ \text{Tax on } £10 \text{ @ } 9/6 & = & \underline{£4 \text{ 15 0}} \end{array}$$

It sometimes happens that a company pays dividends (either "less tax" or "free of tax") despite the fact that it has no liability to tax in that particular year. This is usually due to the operation of capital allowances, but might arise when a company reduced its capital and wiped out a debit balance on profit and loss account and escaped tax by reason of claiming an allowance for losses brought forward from previous years. These circumstances would not deprive shareholders from reclaiming tax in appropriate cases in the usual manner, and is a good example illustrating a company's right to deduct tax from dividends.

In such circumstances the obligatory certificate given by a company to shareholders certifying that "income tax on the profits of the company, of which this dividend forms part, has been, or will be duly accounted for to the proper officer for the receipt of taxes," might appropriately be modified to "any income tax assessable on the profits of the company will be duly accounted for to the proper officer for the receipt of taxes."

The certificate for income tax purposes must be attached to the dividend warrants relating to all dividends whether expressed as being "less tax" or "free of tax."

INTERIM DIVIDENDS.

The powers of directors to declare interim dividends are derived from the Articles. It is customary for an interim dividend to be declared on ordinary shares at the end of the half-year. The actual rate declared is usually less than half the rate which the directors anticipate will be payable for the full year, so as to make some allowance for any unforeseen contraction in profits during the second half of the year.

When a company has no general reserves to fall back upon, the directors may wisely decide that an interim dividend is not justified.

ARREARS OF PREFERENCE DIVIDENDS.

Although the procedure has not previously been enforced, companies have frequently adopted the commendable practice of inserting a memorandum note at the foot of the balance sheet giving particulars of any arrears of dividend on cumulative preference shares. The Eighth Schedule (para. 11) provides that the *gross* amount of any arrears of fixed cumulative dividends on any class of share and the period of arrears shall be disclosed by way of note on the balance sheet or in any statement or report annexed thereto. In those rare cases when such dividends are payable *free of tax*, the amount must be shown free of tax and the fact that it is so shown must be indicated.

This information is of vital interest to prospective shareholders of all classes. The total amount need not be passed through the books as it is a contingent liability, and the dividends do not become a debt due to the shareholders until such time as they are declared by the company.

INTEREST ON CALLS IN ADVANCE.

Interest paid on calls in advance of the due dates is a charge against profits as it must be paid whether net income is earned or not. A shareholder is a *creditor* in respect of amounts paid in advance of calls.

This fact would prove of especial importance in the event of a company going into liquidation between the date of payment of a call by a shareholder, and the due date.

PROFITS AND LOSSES PRIOR TO INCORPORATION.

It frequently happens that, when a company is formed, it takes over a business as from a date prior to incorporation so as to obviate disturbing the continuity of the accounts, and also to dispense with stock and other adjustments on formation. Any profit derived during the period before incorporation is not available for dividends, being a capital profit, since a company cannot make a profit available for the remuneration of its capital before it comes into existence and that capital is created. An example will be seen in the balance sheet and

consolidated balance sheet of Morris Motors, Ltd., in Appendix B. This generally accepted accountancy rule is recognised in the Act which precludes *pre-acquisition profits or losses* of a subsidiary company from being brought into the accounts of a holding company as revenue profits or losses (Eighth Schedule, para. 15).

Profit earned prior to incorporation is usually employed to write-down preliminary expenses, to write-off expenses of issuing shares or debentures, or to reduce the balance of discount on debentures. Alternatively, such profit can be applied to the reduction of goodwill, and this procedure is a commendable one as the price paid for goodwill has probably included an addition in consideration for the company taking over the benefit of profits already earned. (It will be remembered that goodwill, on incorporation, is equivalent to the excess of purchase price paid for a business over the value of net assets taken over.)

Conversely, losses incurred prior to incorporation may be debited to goodwill account, it being similarly contended that the price paid for a business would tend to be lower by reason of the company undertaking to bear losses which have arisen up to the date of taking over the business. Among the objections frequently advanced against this procedure, however, is that shareholders may, on receiving the first balance sheet, find it disconcerting to discover that the prospectus figure for goodwill has been increased in this manner.

An alternative is to transfer a loss prior to incorporation to suspense account, and write off the amount as early as possible.

PROFITS AVAILABLE FOR DIVIDEND.

Article 116 of Table A of the Act directs:—

“No dividend shall be paid otherwise than out of profits.”

This statement is recognised as a fundamental principle of company law, but the question arises: “What are profits for this purpose.” The term “profits” is subject to ambiguity, being capable of varying shades of meaning when used in different circumstances. Officers of a company may be held personally liable to make good dividends paid out of capital, so that the subject is one of considerable importance.

In general it may be said that if the total of the assets in a balance sheet (after proper provision has been made for

depreciation) exceeds the total of the paid-up capital and liabilities, the excess may be regarded as profit available for dividend. The underlying principle is that so long as capital is kept intact* (i.e. represented by tangible assets), any excess may be treated as profit. This concept has earned legal commendation on many occasions, but circumstances may arise which necessitate some qualification of the rule.

Suppose a company disposes of certain fixed assets at a profit, is such profit to be regarded as a surplus on capital account, or may it be treated as a profit eligible for distribution to shareholders? To justify the latter procedure, the surplus must:—

- (a) Accrue from a re-valuation of the assets as a whole, and not from certain selected assets (because an accretion in the value of one or more assets may be counter-balanced by a contraction in the value of others), and
- (b) be a realised surplus.

(It is important to ascertain that the Articles do not prohibit such treatment.)

In *Lubbock v. The British Bank of South America, Ltd.* (1892), an action was brought by some shareholders to restrain the company from distributing as dividend, profit derived from the sale of its goodwill and property in Brazil. The Court, however, held that the profit was really profit on capital and not part of the capital itself; it was the surplus of the assets side of the balance sheet after the paid-up capital and the current liabilities had been deducted; and that the directors, having complied with all the requirements of the Articles of the company, were justified in distributing the profit by way of dividend.

In the case of *Foster v. The New Trinidad Lake Asphalt Co., Ltd.* (1900), an injunction was obtained against the directors, restraining them from treating as profit available for dividend a book debt which had been omitted from the balance sheet as worthless, but subsequently recovered with interest. Mr. Justice Byrne said:—

“The question of what is profit available for dividend depends upon the result of the whole account fairly taken for the year, capital, as well as profit and loss, and although

* For the important considerations relating to the provision for replacement of assets at increased prices see pages 255–265.

dividends may be paid out of earned profits in proper cases, although there has been a depreciation of capital, I do not think that a realised accretion to the estimated value of *one* item of the capital assets can be deemed to be profit divisible amongst the shareholders without reference to the result of the *whole* account fairly taken."

Loss or depreciation of fixed capital does not prevent payment of a dividend, but loss of circulating capital must be made good before a dividend is paid. In this connection the case of *Verner v. The General and Commercial Investment Trust, Ltd.* (1894), is of special interest:—

The Memorandum allowed the company to invest its capital in speculative securities. At the date of the action the company's investments had depreciated to the extent of £240,000, £75,000 of which appeared to be a total loss. The directors proposed to pay a dividend out of the current year's profits, which amounted to over £23,000, before providing for the loss in value of investments. In dismissing the action brought by stockholders to restrain the payment of dividend, on the grounds that no provision had been made for this £75,000 loss of capital, Lord Justice Lindley, in the Court of Appeal, said:—

"The word 'profits' is by no means free from ambiguity. The law is much more accurately expressed by saying dividends cannot be paid out of capital, than by saying that they can only be paid out of profits. . . . Perhaps the shortest way of expressing the distinction which I am endeavouring to explain is to say that *fixed capital* may be sunk and lost, and yet that the excess of current receipts over current payments may be divided; but that *floating or circulating capital* must be kept up, as otherwise it will enter into and form part of such excess; in which case to divide such excess, without deducting the capital which forms part of it, will be contrary to law."

This rule was observed in the later case of *Wilmer v. McNamara & Co., Ltd.* (1895). An action was brought by the ordinary shareholders to restrain the company from distributing a dividend, on the ground that loss of capital had not been made good before arriving at profits. Lord Justice Stirling, in refusing the injunction delivered judgment to the following effect:—

“The Articles provide that ‘no dividend shall be payable except out of profits arising out of the business of the company’ and appear to contemplate ‘profits’ as the excess of receipts over all expenditure properly attributable to the year. There is nothing in the Articles to show that the capital of the company (or rather, assets of the value of those acquired by the company at its formation) must be kept up. I am of opinion that the depreciation of leaseholds and goodwill is to be treated as a loss of fixed capital, and not as a loss of *floating or circulating* capital.”

Although commercially unsound in normal cases and quite contrary to modern practice, it is not *illegal* to divide net income before providing for depreciation of wasting assets if the articles authorise such a course.

This was approved by the Court of Appeal in *Lee v. Neuchatel Asphalte Co., Ltd.* (1889). The circumstances in this case were unusual. The Memorandum and Articles gave the directors power to invest the capital in a wasting asset (a concession for obtaining bituminous rock and mineral products), and expressly exempted them from any obligation to provide for the renewal of any lease or concession or wasting of any asset.

An action was brought by the ordinary shareholders to restrain the payment of a dividend, on the ground that the company had lost part of its capital and had not made it good out of profits before declaring the dividend.

The Court held that the excess of the current year’s income over the expenses properly chargeable to revenue could be treated as profit available for dividend without providing for depreciation of fixed assets.

If the procedure adopted by the company in the case quoted is carried to its logical conclusion there is nothing to prevent a company which comes into existence to carry out a specific piece of work, and limits its activities to the pursuance of that function, from neglecting to depreciate its wasting assets on the grounds that they will not require renewal, and will perform useful service until the company’s work has been done and winding up takes place. (Such powers would, of course, have to be derived from the Memorandum or Articles.)

This principle has strictly limited application in practice, and, when adopted, it would seem highly desirable that share-

holders should be clearly informed that a portion of the dividends received by them represents a return of capital.

From an accountancy standpoint any operation which purposely consumes capital in the process of profit distributions is clearly unsound.

Profits applied in the past to reducing goodwill may be brought back into the profit and loss account, provided the goodwill figure is not unduly inflated thereby. The case of *Stapley v. Read Bros., Ltd.*, has been referred to already, and reference should be made to the words of Mr. Justice Russell reproduced on pages 105 and 106.

The foregoing rules may conveniently be summarised as under:—

- (1) In general, profit shall comprise the excess of total income attributable to the period over all expenses properly chargeable to the period, including provision for depreciation of assets. This rule expresses the commercial and accountancy viewpoint, but it is legally subject to the following qualifications:—
- (2) Loss in value of fixed assets need not be made good before arriving at profits, but loss of floating capital must be provided for out of the income of the current period.
- (3) Dividends may be distributed before providing for depreciation of wasting assets, if this procedure is consistent with the company's Memorandum and Articles.
- (4) *Realised* accretions to the capital assets *as a whole* may be distributed in the form of dividends, provided the company's Articles do not prohibit such treatment.
- (5) Profits applied to the reduction of goodwill in the past may be brought back into the profit and loss account, provided the depreciation written off has not in fact taken place.

Section 65 of the Act authorises payment of interest on capital out of capital, with the sanction of the Board of Trade, where shares are issued for the purpose of constructing works or buildings, or the provision of plant which cannot be made profitable for a lengthened period.

Finally, profits capitalised on redemption of redeemable preference shares cannot at any time resume their revenue nature, and this now applies also to share premiums and E.P.T. Post-War Refunds.

BOOKS OF ACCOUNT. AUDITORS. PRIVATE COMPANIES

BOOKS OF ACCOUNT.

Section 147 requires that every company shall keep *proper books of account to show all amounts received and expended and the matters in respect of which the receipt and expenditure takes place, all sales and purchases of goods and the assets and liabilities of the company.* The section further provides that proper books of account shall not be deemed to be kept *if there are not kept such books of account as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.*

The books of account must be kept at the company's registered office or such other place as the directors so decide and must be open at all times to inspection by the directors. If the books of account are kept at a place *outside* Great Britain, there must, at intervals not exceeding six months, be sent to, and kept at a place in Great Britain and be at all times open to inspection by the directors, such accounts and returns relating to business dealt with in the books of account kept abroad as will disclose with reasonable accuracy the financial position of the business, and to enable the company's balance sheet and profit and loss account to be prepared in accordance with the Act.

Overseas branches are more rigorously controlled by the Act than overseas subsidiaries and there is a danger that some companies may be tempted to reconstruct overseas branches as subsidiaries.

In that portion of the Act relating to winding-up, section 331 imposes penalties of imprisonment upon directors, managers and other officers of a company where it is shown that proper books of account were not kept throughout the period of two years immediately preceding the commencement of winding up "*or the period between the incorporation of the company and the commencement of the winding up, whichever is the shorter.*"

For this purpose, proper books of account shall be deemed not to have been kept in the case of any company if there

have not been kept such books or accounts as are necessary to exhibit and explain the transactions and financial position of the trade or business of the company, including books containing *entries from day to day in sufficient detail of all cash received and cash paid and, where the trade or business has involved dealings in goods, statements of the annual stock-takings and* (except in the case of goods sold by way of ordinary retail trade) *of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.*

In connection with the penalties for which a director is liable for failing to ensure that proper books of account are kept, a new proviso was introduced into the Act by which he may escape liability if he is able *"to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that those requirements were complied with and was in a position to discharge that duty"* (section 147).

Similar provisos are contained in section 148 (relating to the preparation of profit and loss accounts and balance sheets) and section 149 (which contains the overriding "true and fair view" requirement in regard to profit and loss accounts and balance sheets, referred to on other pages).

It is further provided by section 147 that a person shall not be sentenced to imprisonment for an offence under this section unless, in the court's opinion, it was committed wilfully.

LOOSE LEAF BOOKS.

Books of account (also registers, indices and minute books) may now be kept by making entries in other than bound books provided adequate precautions are taken to guard against falsification and to facilitate its discovery (section 436). Penalties may be imposed under this section upon the company and every officer for neglecting to take adequate precautions.

AUDITORS.

A book on the subject of company profit and loss accounts and balance sheets would be incomplete without some consideration of the important rôle played by auditors, their qualifications, appointment, rights, duties and liabilities and also the significance of their report which must be attached to the balance sheet and, since 1st July, 1948, to the profit and loss account and to group accounts.

QUALIFICATIONS.

Prior to 1948 no special qualifications were required for an auditor, and any person other than a director or officer (or partner or employee of an officer) of the company could be appointed auditor, provided due notice was given by the company when a new auditor was proposed for appointment. As the law stood, there was nothing to prevent a company from appointing the local chimney-sweep or ice-cream vendor as auditor, provided such appointment was made by the company in general meeting. This position, on the face of it, was incongruous. While, admittedly, all reputable companies appointed properly qualified accountants as auditors, the law obviously needed strengthening by requiring that every company shall appoint auditors qualified by membership of one or other of the recognised professional accountancy societies. The members of these bodies are subject to the control and discipline imposed by professional organisations, and this affords shareholders and others valuable protection, apart from ensuring that the auditor is properly trained and experienced to perform the work.

The position was remedied by section 161, which provides that no person shall be eligible for appointment as auditor *who is not a member of a body of accountants established in the United Kingdom which is recognised by the Board of Trade as qualifying its members to audit the accounts of companies.*

The bodies at present recognised by the Board of Trade for the purpose of this section are:—

The Institute of Chartered Accountants in England and Wales.

The Society of Incorporated Accountants and Auditors.

The Association of Certified and Corporate Accountants.

*The Society of Accountants in Edinburgh.

*The Institute of Accountants and Actuaries in Glasgow.

*The Society of Accountants in Aberdeen.

The Institute of Chartered Accountants in Ireland.

* In June, 1951, an amalgamation of the Scottish bodies was completed by the granting to The Society of Accountants in Edinburgh of a Supplementary Royal Charter, which changed the name of that Society to THE INSTITUTE OF CHARTERED ACCOUNTANTS OF SCOTLAND, and provided for the amalgamation with it of The Institute of Accountants and Actuaries in Glasgow and The Society of Accountants in Aberdeen.

This provision makes it compulsory (subject to the exceptions mentioned below) for every company to appoint as auditor a member of one of the foregoing recognised professional bodies, thereby ensuring as far as possible the competence and independence of auditors. The Board of Trade may, under section 161, authorise other persons to be eligible for appointment as auditors of companies, i.e.:—

- (a) persons having similar qualifications obtained outside the United Kingdom. (This concession has been introduced for reasons of reciprocity),
- (b) persons who have obtained adequate knowledge and experience in the course of employment by a member of one of the foregoing bodies,
- (c) persons having before the passing of the 1947 Act (i.e. 6th August, 1947) practised in Great Britain as an accountant.

The form of application for authorisation under (a), (b) and (c) above is reproduced on pages 209 and 210.

The foregoing restrictions on the appointment of an auditor do not apply to an exempt private company.

Section 161 further provides that a person appointed as auditor of a company must NOT be:—

- (1) a director or other officer or servant of the company or of a company which is a subsidiary company or a holding company in relation to the first-named company, or of any of the subsidiary companies of such holding company;
- (2) a person who is a partner of or in the employment of a director or other officer of the company or of any of the companies referred to in (1) above. (*The exception previously accorded to private companies is restricted by the new Act to exempt private companies*);
- (3) a body corporate (e.g. a limited company).

The eligibility of auditors of holding and subsidiary companies is dealt with on page 92.

Although an auditor is an *officer* of a company (and accordingly, as such, liable for the various obligations and to the penalties imposed by the Act upon officers), he will not be

deemed to be an officer or servant for the purpose of the foregoing requirements.

There are some who maintain that the common practice (particularly in the case of small companies) of auditors balancing the books and making the final entries is open to objection, since a person who, by himself or by his partner or employee, habitually or regularly acts as book-keeper or accountant to a company, should not be eligible for appointment as auditor of that company.

APPOINTMENT.

A retiring auditor is automatically re-appointed at an annual general meeting without any resolution being passed unless:—

- (a) he is not qualified for re-appointment, or
- (b) a resolution is passed at that meeting appointing another person or providing expressly that he shall not be re-appointed, or
- (c) he has given the company notice in writing of his unwillingness to be re-appointed.

This automatic re-appointment of auditors was first introduced by the 1948 Act and the provision is contained in section 159, sub-section (2). Sub-section (1) requires some amendment because it inconsistently requires that every company shall appoint an auditor or auditors at each annual general meeting.

Where no auditor is appointed or re-appointed at an annual general meeting in accordance with the foregoing provisions, the company is required to inform the Board of Trade within a week, and the Board may appoint a person to fill the vacancy.

The first auditors of the company may be appointed by the directors at any time before the first annual general meeting and auditors so appointed shall hold office until the conclusion of that meeting.

Directors are empowered to fill any casual vacancy in the office of auditor, but while such vacancy continues, the surviving or continuing auditor or auditors, if any, may act (section 159).

Confidential.

Application for Authorisation under Section 161(1) (b) of the Companies Act, 1948, for appointing as auditor of a company other than an exempt private company

I (full name)
of (business address)

hereby apply to be authorised for appointment as an auditor of a company other than an exempt private company and give below particulars of the grounds on which I claim to be entitled to be so authorised.

- A. If the application is made on the ground of your having obtained outside the United Kingdom qualifications similar to those required for membership of a body of accountants established in the United Kingdom for the time being recognised by the Board of Trade under Section 161 (1) (a) of the Companies Act, 1948:—

(i) Particulars of the qualification:—

(ii) When and where obtained:—

A letter from the secretary of the body to which the applicant belongs confirming his membership should be annexed.

- B. If the application is made on the ground of your having obtained adequate knowledge and experience in the course of employment by a member of a body of accountants established in the United Kingdom and for the time being recognised by the Board of Trade under Section 161 (1) (a) of the Companies Act, 1948:—

(i) Are you a member of any body of accountants? If so give particulars:—

(ii) Have you at any time been a member of any body of accountants? If so give particulars and reason for ceasing to be a member:—

(iii) Give particulars of any qualifications in accountancy:—

(iv) Have you at any time been adjudged bankrupt? If so give court, date of adjudication order, and date of discharge, if discharged:—

Particulars of Employment during Past 10 Years.

Name and qualification of employer	Address of employer	Period of Service	Nature of duties undertaken by applicant

If insufficient space provided, the particulars should be given on a sheet annexed.

A reference from a solicitor or bank manager bearing on your accountancy qualifications should be annexed.

C. If on the grounds of having before 6th August, 1947, practised in Great Britain as an accountant:—

- (i) Style in which practice is carried on:—
- (ii) Address of practice:—
- (iii) Period during which practice carried on:—
- (iv) Nature of practice:—
- (v) If accountancy practice is not your sole occupation state other business or occupation and approximate proportion of time expressed as a percentage devoted to each:—
- (vi) If business is carried on in partnership state name of partner or partners and state whether they are making a similar application:—
- (vii) Are you a member of any body of accountants? If so give particulars:—
- (viii) Have you at any time been a member of any body of accountants? If so give particulars and reason for ceasing to be a member:—
- (ix) Give particulars of any qualification in accountancy:—
- (x) Have you at any time been adjudged bankrupt? If so give court, date of adjudication order and date of discharge if discharged:—
- (xi) Particulars of not more than ten current appointments held as auditor with amounts of last fees received, namely:—

Name and address of client	Fee

A reference from a solicitor or bank manager bearing on your accountancy qualifications should be annexed.

I solemnly and sincerely declare that the information given above is true and I make this solemn declaration conscientiously believing it to be true and by virtue of the Statutory Declarations Act, 1835.

Declared at

this day of

19

Before me

(Signed).....

Commissioner of Oaths.

If the applicant is resident outside His Majesty's dominions, the statement should be sworn before one of His Majesty's consuls or vice consuls.

This form when completed should be returned to:—

The Assistant Secretary,
Insurance and Companies Department,
Board of Trade,
Romney House East,
Tufton Street, S.W.1.

Certain safeguards are provided in section 160 to protect shareholders, etc., in cases where it is proposed to appoint a new auditor at an annual general meeting. Special notice* must be given to the company and sent to every member along with the notice of the meeting and notice must be sent to the retiring auditor, if any, *who shall have the right (subject to the provisions of section 160) to make representations in writing to the company (not exceeding a reasonable length) and request their notification to shareholders and if a copy of the auditors' representations is not sent to shareholders, he may require them to be read out at the meeting.* This provision makes it more difficult for directors to dispense with the services of auditors whose criticisms are embarrassing to them.

REMUNERATION.

The statutory requirements as to fixing the remuneration of auditors, which hitherto have been open to some doubt, are clarified by section 159.

Remuneration must be fixed, either by the company in general meeting, *or else in such manner as may be determined by the company in general meeting.* For example, auditors may be appointed "at a remuneration to be fixed by the directors." It is important to note that where the remuneration is NOT fixed by the company in general meeting, the amount thereof must be stated *as a separate item* in the profit and loss account and must include any sums paid as expenses (Eighth Schedule, para. 13). The fee paid to auditors as such and their charge for pure accountancy services therefore now needs to be segregated. The latter should be treated as a general expense of the business.

It may often be impossible to ascertain the exact remuneration and expenses applicable to the audit at the time of completing the accounts. In such circumstances an estimated amount should appear in the accounts, any subsequent adjustment being shown in the accounts of the following period.

When the auditors' expenses are not fixed in general meeting, *both* remuneration and expenses should be disclosed in the profit and loss account (in one amount).

Directors are empowered to fix the remuneration of auditors appointed before the first annual general meeting, or of an auditor appointed to fill a casual vacancy. The remuneration

* As to what constitutes a "Special Notice," see section 142.

of an auditor appointed by the Board of Trade may be fixed by the Board (section 159). In all such cases the amount of the fee will require to be shown in the profit and loss account. This provision ensures therefore that shareholders shall be cognizant of the fees paid to auditors in all cases.

RIGHTS OF AUDITORS.

Under section 162 every auditor of a company has a right of access at all times to the books, accounts and vouchers of the company and is entitled to require from the directors and officers of the company such information and explanations as *he thinks necessary* for the performance of his duties. The words in italics are a significant addition to the corresponding provision in the 1929 Act. The point here is that it is *for the auditor to judge what is necessary for the performance of his duties*.

Auditors are now entitled to receive notice of and attend ANY general meeting of the company and to make any statement or explanation they desire at such meeting on matters which concern them as auditors (section 162). Prior to 1948, auditors were only entitled to attend any general meeting at which accounts examined or reported on by them were laid before the company.

A view has been expressed that the law should give auditors the right of access to the accounts of any subsidiary of the company whose audit they are conducting and to require from the officers of the subsidiary such information and explanations as they may consider necessary.

AUDITORS' REPORT.

Auditors are required by section 162 to make a report *to the members* on the accounts and on every balance sheet *and profit and loss account and all group accounts* laid before the company in general meeting during their tenure of office and the report must contain statements covering the matters set out in the Ninth Schedule (see Appendix A).

It will be noticed from the auditors' reports appended to the accounts in Appendix B that the customary form closely follows the wording of the Ninth Schedule. Auditors' reports are undoubtedly too long and there is a danger that when qualifications have to be made they may be partly obscured by the excessive phraseology which has to be employed. It

would seem better if auditors were merely required to report that, in their opinion, the matters contained in the Ninth Schedule had been complied with by the company and in those cases where they were not of that opinion, any qualifications could be specifically set out. Such qualifications would then be more conspicuous. Shareholders and others are usually only interested to know whether auditors have given an unqualified report.

The Act places more onus upon auditors. Auditors were not formerly required to report upon the profit and loss account although, as the balance of the account is brought into the balance sheet, they could not report upon the balance sheet without enquiring into the accuracy of the profit and loss account. As the profit and loss account is now required to be set out in some detail, the auditors are, as a corollary, required to report as to whether it is properly drawn up *in accordance with the provisions of the Act*. Group accounts, which were not, of course, generally prepared prior to 1948, must now be covered by the auditors' report.

The Act of 1929, moreover, merely required the auditors to report whether the balance sheet was properly drawn up so as to exhibit a true and correct view of the state of the company's affairs "as shown by the books of the company." It was felt in some quarters (although the professional bodies of accountants did not take such a narrow view) that if a company's affairs were incompletely revealed by its books, the auditors might have felt that they were entitled to certify that the balance sheet was properly drawn up if it was merely in accordance with the books. It will be observed that auditors are now required to report whether, in their opinion, proper books have been kept.

The significance of the change from being required to report on a true and *correct* view to a true and *fair* view should also be noticed. There are many occasions when items may appear in the accounts which correctly reveal the results of transactions which have taken place but do not necessarily give a *true and fair view*. To take a simple example: freehold buildings may have stood in the books at £40,000, the figure having been derived from the purchase of two properties at £20,000 each. If one had been sold for £39,000, the asset account might be "correctly" shown in the balance sheet at £1,000, but that would not represent a *fair* view.

The expression "true and fair" view must be construed in relation to the general requirements of the Act and in accordance with accepted accountancy principles.

DUTIES AND LIABILITIES OF AUDITORS.

The auditor's duty in relation to the balance sheet is to satisfy himself that it is properly drawn up so as to exhibit a true and fair view of the state of the company's affairs and that the profit and loss account gives a true and fair view of the profit or loss according to the information and the explanations given to him by directors and other responsible officials of the company. His responsibility is *to the shareholders*, by whom he is appointed.

The auditor does not, as is supposed in some quarters, give an unconditional guarantee that the balance sheet and profit and loss account are accurate in every detail. To place such a responsibility upon his shoulders would be unreasonably onerous since he cannot be expected to possess an intimate knowledge of the technical peculiarities of each business he investigates.

In connection with certain balance sheet valuations, he is entitled to rely upon the opinions of responsible officials whose close association with the business renders them more qualified to express judgment. The assessment of the value of stock-in-trade is an example of this, as also are the rates and methods of depreciation applied to machines and plant of which the auditor will normally have little or no technical knowledge although, if called upon to do so, he should always be ready to give advice and place his accounting experience at the disposal of clients.

The auditor must, however, exercise reasonable skill, care and caution to satisfy himself that the accounts show the true state of affairs. He must employ such skill as might be expected from a competent accountant, not merely to vouch the accuracy of the balance sheet, profit and loss account and group accounts with the books, but to apply those tests which he considers necessary to verify the correctness of the entries in the books.

As stated in the widely quoted *Kingston Cotton Mill* case (1896), an auditor "is a watch-dog, not a bloodhound." He is entitled to assume that servants trusted by the company are

honest, and to rely upon their statements provided he takes reasonable care. If, however, there are any circumstances calculated to evoke his suspicion he would be considered lacking in his duty if he neglected to probe them to the bottom.

The dictum laid down in the *Kingston Cotton Mill* case has been somewhat whittled down in more recent years, in consequence of several cases decided in the Courts, notably the *Westminster Road Construction and Engineering Company, Ltd.* case (1932).

In this case the auditor was held liable for a wrong payment of dividend based on accounts passed by him. The accounts showed a profit of £3,458, whereas there had been a profit of only £297, this over-statement of net revenue being brought about by an excessive valuation of work-in-progress. Sums had been included in the work-in-progress figure for work not done until after the date of the balance sheet, allowances for re-instatement charges payable by the company to sub-contractors had been omitted, and no provision had been made for bad debts.

The auditor had accepted the certificate of work-in-progress given by the manager and secretary to the company without making certain enquiries which would have revealed that the valuation for balance sheet purposes was inflated. As stated, the auditor was held liable, and the directors were absolved from parallel claims made by the liquidator of the company against them.

If the auditor does not show reasonable skill, care and caution in the performance of his duties, he may be liable to make good losses suffered by shareholders in consequence of his default. He should therefore exercise caution to ensure that statements furnished by directors and others are accurate, e.g. stock schedules should be tested for accuracy and steps should be taken to ensure that a consistent basis is adopted from year to year.

Examples of reports now given by auditors are reproduced at the foot of the balance sheets in Appendix B. Any departure from this orthodox phraseology constitutes a qualification and should be regarded by shareholders and creditors as a danger signal. If the auditor reports that he has been unable to verify the documents of title to investments, or land and buildings, or that he has not obtained full explanations concerning certain assets, or that he considers the provisions for depreciation inadequate, this denotes that he is dissatisfied in certain respects, and the warning should be heeded.

The auditors' responsibilities in relation to depreciation are discussed on pages 45-46.

It has been suggested by some economists that an auditors' report that endorses a set of accounts which has not taken cognizance of amounts required to be set aside to meet increased replacement costs before profit is ascertained is open to criticism. It does, however, seem to be clear that, at the present time, "true and fair" means true and fair in accordance with accepted accounting concepts and with the provisions of the Act. The effects of inflation in relation to accounts is a topical and controversial subject of considerable importance and is discussed in Chapter XV.

PRIVATE COMPANIES.

Private companies are a very important feature in the commercial and industrial life of this country to-day. Although joint stock companies have been in existence for over three hundred years, it was only forty-five years ago that private companies were first accorded legal recognition. At present about nineteen out of every twenty companies are private companies and the aggregate paid-up capital of private companies is more than half that of public companies.

The statistics reproduced in the Cohen Report and shown below illustrate, not only the increase in the number of private companies, but also the increase in the proportion of private to public companies:—

Year	PUBLIC.		PRIVATE.	
	No.	<i>Paid-up Capital</i> £ million.	No.	<i>Paid-up Capital</i> £ million.
1930	16,263	3,894	95,598	1,591
1934	14,852	3,851	115,603	1,697
1939	13,920	4,117	146,735	1,923
1944	13,303	4,052	169,205	1,935

The corresponding figures at the end of 1949 were:—

12,075	3,854	231,443	2,094
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During the year 1950, 183 public companies and 13,095 private companies were registered, the aggregate paid-up capitals being £1,226,725 and £66,535,347 respectively. (The figures for public companies include 157 "Guarantee" companies—mostly with no share capital.)

Whereas the minimum number of members in a public company is seven, a private company may be formed with *two*

members only and, as explained at the end of this chapter, for all practical purposes the financial interest in a private company may be confined to one person only. The facility for converting a business into a private company is open to an individual trader just as effectively as it is to a partnership firm and all the advantages of company incorporation are derived. These include limited liability for all members, legal entity for the business, continuity of existence apart from the shareholders and division of financial ownership into two or more classes of shareholders, each possessing different rights as to profit-sharing, voting powers, etc. The advantages of corporate constitution may also be derived by clubs and societies who may acquire land and property in the name of the company instead of having to appoint trustees from among their members, an unsatisfactory procedure, entailing troublesome and expensive formalities whenever trustees die or resign from membership.

The fact that the constitution and internal regulations of a company are defined in the Memorandum and Articles of Association, which can be altered only in accordance with the provisions of the Act, is an advantage of practical value in many instances. This, for example, encourages the proprietor of a business, who may be of advancing years, to admit members of his family or other persons into co-ownership, subject to such limitations of their executive capacity, powers, profit-sharing rights, etc., as he may impose.

DEFINITION OF PRIVATE COMPANY.

From the definition of a private company given in section 28 it will be seen that the Articles must:—

- (a) Place a restriction upon the right of members to transfer their shares. (Normally the consent of the directors is required and the following is a clause which is often used: "*The shares shall be at the disposal of the directors who may allot and issue them in all respects as they may think fit.*")
- (b) Limit the number of members to *fifty*, exclusive of employees and past-employees who have continued to be members.
- (c) Prohibit any invitation to the public to subscribe for shares or debentures of the company. (All shares and

debentures must therefore be placed privately. They are usually subscribed for by members of a family, friends, business acquaintances, etc.)

PRIVILEGES.

A private company enjoys the following privileges:—

- (1) It may carry on business with a minimum of *two* members (i.e. shareholders), and even one member may carry on business for six months before his liability becomes unlimited (sections 1 and 31).
- (2) It may commence business without the formalities to which a public company is subject (section 109).
- (3) It is not required to hold a statutory meeting or to file a statutory report (section 130).
- (4) No minimum subscription need be reached before shares are allotted (section 109).
- (5) It is not required to file signed consents of directors (section 181).
- (6) No statement in lieu of a prospectus need be filed before shares are allotted (section 48).
- (7) Two or more directors may be appointed by a *single* resolution (section 183).
- (8) Minimum number of directors is one (section 176) but a sole director must not also be secretary (section 177).
- (9) Its directors are not subject to the provisions of section 185 in regard to retirement at the age of seventy (unless the company is a subsidiary of a public company).
- (10) A proxy appointed to attend and vote instead of a member of a private company has, subject to the provisions of section 136, the same right as the member to speak at the meeting.
- (11) A director may not be removed by resolution if he held office for life on 18th July, 1945 (i.e. when the Cohen Report was published) irrespective of whether he is subject to retirement under an age limit by virtue of the articles or otherwise (section 184).

"EXEMPT" PRIVATE COMPANIES.

Since the Act came into force private companies do not enjoy all the advantages hitherto attaching to their constitution unless they qualify as "EXEMPT" companies. Most

private companies (including thousands of small family businesses) are of this type, but it is not now possible for public companies to avoid some of the requirements of the Act by functioning as subsidiaries of private companies.

An "exempt" private company is one which certifies annually that :—

- (1) *No body corporate is the holder of any shares or debentures, and*
- (2) *No person other than the holder has any interest in any of the shares and debentures, and*
- (3) *The number of debenture-holders does not exceed fifty (joint holders being treated as a single person) (section 129), and*
- (4) *No body corporate is a director and that no arrangement exists whereby the company's policy can be determined by persons other than directors, members or debenture-holders or trustees for debenture-holders (section 129).*

Numbers (1) and (2), referred to as "basic conditions," are contained in the Seventh Schedule, and are subject to the exceptions set out in that Schedule. For example, (1) above does not apply if another company which is itself an "exempt" private company is the holder of shares and (2) is subject to exceptions in cases of death and family settlements and for certain dealings of a normal business nature, such as shares or debentures held subject to a charge in favour of a bank, etc.

In addition to the privileges enjoyed by all private companies, as already set out, exempt private companies need not:—

- (1) File with the annual return a balance sheet and the documents required to be annexed thereto (including a profit and loss account), a directors' report, and an auditors' report (section 129).
- (2) Comply with section 161 in regard to the qualifications of an auditor (as set out earlier in this chapter).

Thus, any person may be appointed auditor of an exempt private company except a director or other officer or servant of the company, a body corporate or a person disqualified from acting as auditor of the company's subsidiary or holding company or a fellow-subsidary of the same holding company (section 161).

- (3) File a *printed* copy of any resolution or agreement required under section 143, provided a copy is filed in *some other form* approved by the registrar.
- (4) Observe the restriction of the Act on loans to directors (section 190).

Disclosure of such loans must, however, be made in the balance sheet in accordance with section 197.

One of the effects of the introduction of this new type of company is that many private companies which do not qualify as "exempt" companies are now presenting accounts which are less informative than formerly (e.g. by omitting turnover figures).

It is not at all clear why the maximum number of debenture-holders in an exempt private company should not be exclusive of employees and ex-employees, as in the case of the maximum number of shareholders and perhaps this is another matter which will be the subject of attention when the law is next amended.

CIRCULATION OF ACCOUNTS.

Section 158 provides that every shareholder and debenture-holder shall be entitled to receive without payment, not less than twenty-one days before the general meeting each year, a copy of the profit and loss account, balance sheet, auditors' report and all statements required by the Act to be annexed thereto. Shareholders and debenture-holders (but not the Registrar nor the public in the case of "exempt" private companies) now therefore have the same right to copies of the accounts, *including the profit and loss account*, as members of a public company.

The existing statutory requirements are set out on page 14.

The provisions as to the appointment of auditors is the same for a private company, other than an "exempt" company, as for a public company.

OPPRESSION OF MINORITY SHAREHOLDERS.

Cases have arisen from time to time where minority shareholders have found it difficult to resist oppression by the majority. To quote an example of one abuse, directors have sometimes absorbed an undue proportion of the profits in remuneration for their services so that little or nothing was

left for distribution among the shareholders by way of dividend. Section 210 provides that the powers of the Court shall be enlarged so that where the affairs of a company are being conducted in a manner oppressive to some members, the Court may, with a view to bringing to an end the matters complained of, *make such order as it thinks fit* to remedy the position, when the winding up of the company would unfairly prejudice the complaining members.

This new relief provided by section 210 applies only when the facts would otherwise justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up. This limits the operation of the remedy in practice.

A dissatisfied shareholder can, as an alternative, take advantage of section 164 which gives the Board of Trade power to appoint inspectors to investigate the company's affairs on the application of not less than two hundred members OR of members holding not less than *one-tenth* of the shares issued. The application must be supported by evidence showing that the applicants have good reason for requiring the investigation and security up to £100 may be required for the costs of the investigation.

Many such applications are received by the Board, mostly by members of small private companies and in most instances the Board have met the parties or arranged for them to meet and the difficulties have been adjusted without the appointment of inspectors.

"ONE-MAN" COMPANIES.

This expression is somewhat misleading since the minimum number of members in a private company is *two*. When, however, one person is the holder of almost all the shares, the company is often referred to as a "One-man Company." Thus, if a trader converts his business into a company with a capital of £10,000, divided into 10,000 shares of £1 each, and desires to retain virtual ownership of the business himself, he may arrange for up to 9,999 shares to be allotted to himself and the remaining one or more shares to another person (e.g. his wife, son, business manager, etc.).

Despite the "one-man" character of such companies, which are not uncommon, *all* the requirements of the Act relating to private companies must be observed. For example, a general

meeting must be held annually, of which "all" shareholders must be given the requisite notice of twenty-one days.

PROHIBITION OF LARGE PARTNERSHIPS.

Section 434 provides that no partnership consisting of more than *twenty* persons, which has for its object the acquisition of gain, can be formed *without being registered as a company*.

If the business is that of banking, the maximum number of partners is *ten* (section 429).

CHAPTER XIII

SIMPLIFIED ACCOUNTS

Reference to the new, but rapidly growing practice of supplementing the published accounts of public companies with simplified statements was made on page 8. The value of these statements to those unacquainted with the intricacies of accounting is being increasingly appreciated, both by directors and company executives, including accountants.

As mentioned on that page, accountants themselves are becoming increasingly conscious that, admirable as most of their efforts have been in the interpretation of the accounting provisions of the Act so as to reflect fully the spirit of the "true and fair view" overriding requirement of section 149, the accounts produced as a result have, on the whole, proved to be too comprehensive and technical for the vast majority of shareholders to digest.

It is probably not an overstatement to say that no company is too large nor its ramifications too wide to preclude the preparation of a statement in simple terms of the main changes that have taken place in its revenue position during the year and a concise tabulation of the capital employed and the employment of that capital as at the end of the year.

Some suggestions on the preparation of simplified statements are given in this chapter and several examples are reproduced. These may be modified or extended as necessary to meet the particular requirements of an individual company. The preparation of such statements offers the accountant or secretary wide scope for ingenuity and resource. That they will be welcomed by shareholders, debenture-holders, employees and their representatives, stock exchanges, banks, financial journalists, etc., is certain, but care must be exercised to ensure that the process of simplification does not give rise to distortion in the more tabloid presentation of the financial results and position of the company.

FUNDAMENTALS OF SIMPLIFIED ACCOUNTS.

The ideal to aim at is to produce statements which "a child can understand," but it is advisable to bear in mind that all

the figures quoted should be in accordance, and capable of identification at a glance, with the full accounts as produced in compliance with the Act.

It is emphasised that these simplified statements are entirely supplemental to the normal accounts and in no respect are they presented in substitution. The profit and loss account and balance sheet, together with group accounts where applicable, must, of course, be prepared in compliance with the Act so that the fullest possible disclosure of the company's finances shall be available for shareholders and others. While the normal accounts should be designed in the most comprehensible and easily-digested manner by appropriate grouping and arrangement of narrative and figures, any simplified accounts which are supplemented are intended for those who are unacquainted with the basic principles of accounting or those with neither the time nor the inclination to peruse the full accounts.

ADVANTAGES OF SIMPLIFICATION.

The former group inevitably constitutes a very considerable proportion of shareholders and the provision of simplified summaries is undoubtedly worth while. We are all familiar with the shareholder, instinctively allergic to figures, who, on receiving his accounts, takes a cursory glance at the profit for the year and the rate of dividend proposed, and then immediately consigns the whole document to the waste paper basket.

This movement to furnish him with simplified accounts may have the effect of delaying the passage of the accounts to the waste paper basket but, perhaps what is more important, is the possibility that the simplified accounts may stimulate him to take some interest in the affairs and finances of the company. He may even be tempted to refer to the full accounts for more detailed information. In this way the simplified statements may act as an introduction to and a concise explanation of the main structure of the normal accounts.

In these days, when it is becoming more common to encourage employees and their representatives to interest themselves in the financial position, plain straight-to-the-point reproductions of the salient features of the accounts are of real value.

Even the accountant, perusing the published accounts of a company, may find that simplified statements afford a

convenient first quick impression of the finances before an exploration of the full accounts is made.

CRITICISMS OF SIMPLIFIED STATEMENTS.

There are, of course, some accountants who are prejudiced against any attempt to provide help for the shareholder whose natural inclination is to destroy at sight the accounts he receives. They take the view that if the fullest possible information is given to shareholders, that is as far as the company should go. The company has satisfied its legal obligations and if a shareholder, through ignorance, laziness or carelessness, does not take advantage of what has been provided for him by a benevolent legislature and a scrupulous company, that is his own affair.

PROBABLE FUTURE DEVELOPMENTS.

There is little evidence to suggest that this viewpoint is widely held within the profession and it is likely that considerable interest and attention will be given to this subject of simplified statements in the immediate future. Already many prominent public companies have adopted the practice and there is little doubt that their efforts in this direction have met with the appreciation of their members, employees and all who have had occasion to peruse their accounts.

The Management Accounting Team, which recently visited the United States under the auspices of the Anglo-American Council of Productivity, were very impressed with the drive towards simplicity in American financial statements.

SOME SPECIMEN SIMPLIFIED STATEMENTS.

This first example of simplified accounts shows the total net assets and how the figure is represented:—

					£
Fixed Assets	..	..	..	..	126,842
Investments	..	..	..	..	30,000
Current Assets, <i>less</i> Liabilities..				..	89,218
					246,060
<i>Deduct</i> Debentures	..	..	..	..	55,000
TOTAL	..				<u>£191,060</u>

This total represents the shareholders' financial interest in the company and is made up of:—

Ordinary Stock	40,000
Capital Reserves	26,500
Revenue Reserves	49,560
	116,060
Preference Stock	75,000
	<u>£191,060</u>

Alternatively, the preference stock may advantageously be deducted from the total net assets in order to show the equity of the company and how this is made up, thus:—

Total Net Assets <i>less</i> Debentures (from previous page)	191,060
<i>Less</i> Preference Stock	75,000
Ordinary Shareholders' Interest ..	<u>£116,060</u>
	<i>made up of:</i>
Ordinary Stock	40,000
Capital Reserves	26,500
Revenue Reserves	49,560
	<u>£116,060</u>

To this tabulation, the following statement might usefully be added:—

The NET ASSET value of each 5s. unit of Ordinary Stock is 14s. 6d.

The next suggestion for simplified statements shows the "net worth," the proposed profits distribution, and the dividend related to *both* issued and employed capital:—

	£
Current Assets	80,000
<i>Less</i> Current Liabilities	15,000
Surplus of Current Assets over Current Liabilities	65,000
<i>Add</i> Fixed Assets (exclusive of Goodwill)	90,000
Total—NET ASSETS	<u>£155,000</u>
<i>Represented by:</i>	
6% Preference Shares of £1 each ..	60,000
Ordinary Shares of 10s. each ..	40,000
Total—CAPITAL	100,000
Surplus—Reserves and Undistributed Profits	55,000
TOTAL ..	<u>£155,000</u>

Proposed Appropriation of Profit for Year:

Taxation	14,800
Dividends (net)	4,620
Increase in Reserves	8,500
NET PROFIT FOR YEAR	<u>£27,920</u>

Proposed Final Dividend on the Issued

Ordinary Capital (*less* tax) 8%.

Making a dividend (*less* tax) for the year of 12%.

Equivalent to 5.05% on the ACTUAL CAPITAL employed in the business.

The foregoing may be further simplified by showing the net profit after deduction of preference dividends in order to emphasise the profit belonging to ordinary shareholders, i.e. the equity.

Sometimes it is useful to show in a simple statement the changes that have taken place during the year in a form similar to this:—

This is what has happened during the year:—

NET NEW FUNDS—

After deducting costs, the new funds which came into our coffers were:—

Trading Profits	286,000
Sundry exceptional profits (unlikely to recur)	4,000
	290,000
Less Taxation	162,000
Appropriations	79,000
	241,000
	49,000
Profit on Sale of Buildings	16,000
Proceeds of New Issue of Preference Shares	50,000
	<u>£115,000</u>

THESE FUNDS WERE APPLIED AS FOLLOWS:—

Extensions to, and Purchases of, Buildings, Plant and Transport Vehicles	63,000
Additional Working Capital (see next page)	52,000
	<u>£115,000</u>

ADDITIONAL WORKING CAPITAL was employed as follows:—

Increase in Stocks	22,000
Increase in Debtors	12,000
Increase in Investments	10,000
Increase in Cash	7,000
Reduction of Bank Overdraft	8,000
	59,000
Less Increase in Trade Creditors	7,000
	<u>£52,000</u>

CLARITY IN PUBLISHED ACCOUNTS.

Several companies have recently published accounts which are so effectively designed that the additions of simplified statements is almost superfluous. By the skilful arrangement and grouping of items and the relegation of detail to notes and schedules, the main financial structures are displayed with the utmost clarity. The accounts of Fisons, Ltd., reproduced on pages 392–396, may be regarded as representative of this high standard. It may be that some companies will find a solution to the problem along these lines as an alternative to the publication of simplified statements.

When the auditors' report covers supporting schedules, the balance sheet can be confined to main headings and still comply with the Act. This enables adequate explanatory detail to be given in the schedules and a simplified skeleton lay-out to be adopted in the balance sheet.

A BALANCE SHEET IN ITS SIMPLEST TERMS.

Perhaps the most interesting example of accounts drafted in a form in which "a child can understand" are those of Jantzen (Australia) Ltd. This balance sheet, which is reproduced on the opposite page is almost a lesson in elementary book-keeping.

Another balance sheet which gives a lucid narrative against each figure is that of the Colgate-Palmolive-Peet Company of America.

EXPLANATORY BALANCE SHEET

Listing what we owned, what we owed, and what we were worth at the close of our Financial Year, 31st March, 1960
(and as compared with the position a year earlier)

1949	1950		1949	1950
£	£		£	£
		ASSETS . . . What We Owned.		
386	441	CASH ON HAND: This amount is the total of various petty cash and stamp funds	88,000	
53,683	146,574	ACCOUNTS RECEIVABLE: Total owed us by our customers for merchandise less estimated amounts which we may not be able to collect, together with amounts due by salesmen, agents and sundry debtors	30,107	
370,486	312,367	INVENTORIES: This is the value of raw materials, garments in work and finished products on hand or in transit at the close of the year	5,813	
78	254	DEFERRED CHARGES: In the operation of the business, services such as insurance, rates and taxes are paid in advance. This amount will be used during the ensuing year	30,996	
86,323	96,688	LAND, PLANT AND EQUIPMENT—DEPRECIATED COST: This is the amount we paid for our land, buildings, machinery and equipment, less an estimated allowance for loss in value because they are gradually wearing out or becoming obsolete	7,997	
		PATENTS, TRADE MARKS, &c.: When this company commenced operations in 1928 the sum of £19,000 was paid to the Jantzen Knitting Mills Inc., U.S.A., by the issue of 16,000 ordinary shares of £1 each fully paid. In return an agreement was made transferring to our company certain patents and trade marks and giving an undertaking to supply us in perpetuity with technical, styling and advertising information. In subsequent years an amount of £8,000 was written off by appropriation of profit. The company's directors consider the value of this asset is conservatively stated at	169,912	
10,000	10,000		257,053	
£419,965	£585,304		£419,965	£585,304
		LIABILITIES . . . What We Owed.		
		BANK OVERDRAFT (Secured): This represents money borrowed from the bank for the purpose of carrying on our operations		156,065
		ACCOUNTS PAYABLE: Amounts we owed for the purchase of manufacturing materials, supplies and services, together with sundry amounts due to associated companies and others		56,933
		MISCELLANEOUS ACCRUALS: This represents an estimate of sundry expenses incurred, an amount set aside for sick and holiday pay and salaries and wages earned, but not paid at 31st March, 1950		7,794
		PROVISION FOR INCOME TAX: This represents the estimated amounts due to the Australian and New Zealand Governments for income taxes		47,615
		PROVISION FOR DIVIDENDS PAYABLE: This is the further amount we expect to pay to shareholders for dividends out of profits for this last completed financial year		8,904
		SHAREHOLDERS' FUNDS . . . What we Were Worth.		
		CAPITAL, RESERVE AND SURPLUS: This represents the investment in the business by 388 shareholders		289,765
				£585,304

NOTE: The balance sheet published by Jantzen (Australia) Ltd., from which the above statement is compiled, is reproduced on page 390.

TURNOVER ANALYSES.

Statements showing how gross turnover has been disposed of, often embodied in directors' reports, are dealt with in Chapter XIV. Such tabulations are further examples of simplified statements produced to reveal as vividly as possible the salient features of the accounts and to express domestic information in a form pertinent to current economic and political conditions.

DIRECTORS' REPORTS AND OTHER CONTACTS BETWEEN BOARDROOM AND SHAREHOLDERS

It is not an over-statement to say that the relationship between directors and shareholders in this country is normally a very distant one. In most companies the line of communication between the boardroom and the members is politely casual; very often it is even cold and formal.

Although there is a considerable number of exceptions, most companies in this country confine their director-shareholder contacts to the publication of the annual accounts, the holding of the annual general meeting (both of which are compulsory) and the circulation of the directors' report (which, as already mentioned, is obligatory in certain circumstances).

AMERICAN METHODS.

It may be of interest to contrast this with what frequently happens in America. No sensible person, of course, would assert that all American practices are necessarily appropriate to conditions here—the temperament and character of the British people are cast in a rather different mould. Some of the more blatant publicity methods adopted by our American friends are repugnant to our traditional conceptions of good taste and in some cases would be the antithesis of expediency. At the same time, it is interesting to reflect on some of the company practices in the States, if only because this may be a preview of developments on more modified lines here—evidence of which is already apparent.

Even in America views have recently been expressed that directors should devote their attention to strengthening still further the links between the board and the general body of shareholders and among the specific criticisms has been one that the value of the list of members as a mailing list was

insufficiently appreciated. The wide field of membership of a large company should be regarded as a valuable potential sphere of influence—for the creation of goodwill, for the expansion of sales, for the enhancement of customer-relations and for the marshalling of public opinion in opposition to legislation of a restrictive or onerous character. By the despatch of literature at frequent intervals—news-letters, brochures, folders and the like—or by regular (e.g. quarterly or half-yearly) publications, it is claimed that much progress can be achieved in these directions.

In America the annual report often contains interesting information relating to the company in addition to the more obvious contents, i.e. the accounts, proposed appropriations, analysis of turnover, election of directors, etc. Such features as a map showing the location of the various activities of the company, illustrations of new plant and factory lay-outs, descriptions and pictures of staff amenities such as clubs, canteens, sports pavilions, etc., are included. In addition, financial statistics displayed geographically, descriptions of selling and advertising activities, researches and plans for future policies, information about officers or directors and even a touch of glamour introduced by photographs of feminine members of the staff who have met with success in beauty competitions, are to be seen gracing the pages of the annual report. Some of this American publicity is produced on a lavish scale with a high standard of quality in paper and illustrations, and commensurate efficiency in general lay-out and design.

Some of these published accounts appear to us to be more like a combination of "Picture Post" and "The Readers' Digest"! Americans were sceptical at first as to the value of these voluminous statements but now not only accept them as a commonplace but appreciate them.

The annual meeting—so frequently a formal and sombre affair—is sometimes enlivened by the introduction of films depicting the policy or activities of the company and by revealing diagrammatically recent financial progress. Light refreshments are at times served at the annual general meeting and the conveyance of members from the main-line termini to the place of the meeting and back again is not unknown. Product displays and photographs are sometimes set up in the meeting hall, with qualified staff available to answer questions before and after the meeting. Often a detailed

digest of the proceedings is sent to every proprietor. Some companies send a letter of welcome to every new shareholder, taking the opportunity of making him aware of the company's activities. When a member ceases to be a shareholder a letter of regret is sent to him pointing out that the board hopes he will not cease to continue his personal interest in the company's activities, and a hope is expressed that his cessation of membership is not due to any cause which could have been avoided by the board.

Many secretaries and directors in this country will view with apprehension the conception of the relationship between directors and shareholders implied in these practices, even if they do not regard such suggestions with unqualified hostility. But there are many who do not appreciate as yet that several progressive companies here have already experimented on the lines of some of the expedients outlined above; and there is no evidence to suggest that such innovations have been unfavourably received or that the companies concerned have not added to their prestige by such modernisation of outlook. It is certainly a fact that the financial and professional press have accorded a most hearty welcome to the annual reports of progressive companies which have recognised the value of these documents as a means of improving the lines of communication between the boardroom and the members, and as a medium for educating and interesting the shareholder in the company's day-to-day activities.

There is a growing appreciation in this country of the value of shareholder relations, which often stands a company in good stead when it requires additional capital, quite apart from its tendency to enhance the goodwill of the business. Good shareholder relations are comparable with good public, customer and employee relations.

Many company officers will be appalled at any practice which involves a danger of revealing information to competitors. However justified this may be in individual cases, it is not without significance to reflect that industrial competition is more virile in America than it is here! The American view is that fully informative accounts do not impinge upon competition. The broad outlook is taken that competitors will probably get the information in any case.

It is probable that, if the practice of issuing more elaborate reports becomes prevalent here, even those who are at present

prejudiced against such a practice will discover that some benefit is derived from having available detailed information published by competitors when making long-term budgets and in planning ahead. In America competitors often exchange accounts by mutual arrangement.

Accountants, however, may sometimes be forgiven for expressing apprehension that their efforts in producing the annual accounts may be overshadowed by the more spectacular and aesthetic products of the "blurb-producers," artists and other publicity specialists who have contributed to an elaborate brochure.

THE DIRECTORS' REPORT.

Turning to prevailing practices here, how many companies confine the contents of the directors' report to the bare bones of the requirements of section 157, which merely requires the inclusion of a general statement of the company's affairs and the directors' proposals as to dividends and transfers to reserves? (The section also requires that if there has been any change in the business of the company or in its subsidiaries or in the classes of business in which the company has an interest, whether as a member of another company or otherwise, this must be dealt with in the report, *if it is material for the appreciation of the state of the company's affairs by its members, and will not, in the opinion of the directors, be harmful to the company.*)

The last-mentioned provision was introduced into the amending Act of 1947 as a result of representations made in Committee in the House of Commons, it being stressed that a company could normally make quite appreciable changes in the nature of its business which might still remain *intra vires* the memorandum.

As stated on page 193 (where the recommendations of the Millin Commission are reproduced) it is not difficult to envisage that when the law relating to companies is again amended, the provisions relating to directors' reports will be made more comprehensive.

Examples of directors' reports of three well-known companies have been included in Appendix "B."

Taking advantage of the proviso in section 163, some companies do not issue a directors' report at all. (This proviso, as stated on page 193, applies only when information which the

Act allows to be shown in a document annexed to the accounts as an alternative to being shown in the accounts, is *not* included in the report). In the author's view this exemption should be restricted to exempt private companies.

AN AUSTRALIAN EXPERIMENT.

An interesting competition in Australia was conducted by the Institute of Industrial Management, Sydney, for the best company annual report published during 1950. The aim of the competition was to improve the form of presentation and content of annual reports and financial statements, and thus to:—

1. Make known the important place of private enterprise in the community.
2. Encourage the dissemination to shareholders and others of information about company activities in a form which those without business training can understand.
3. Endeavour to establish better employee-employer relations by making known facts about the company and the financial result of its activities, and to endeavour to create employee pride in the company, its products and the services which it provides.

The primary aim of the competition was to encourage directors to take a greater interest in the presentation of information in such a way that it could be understood by people who were not familiar with financial and accounting jargon.

All the twenty-one merit entries (including the winning entry) gave figures to the nearest £ and used distinctive covers for the reports, which were printed in two or more colours. Sales figures were disclosed by seven companies, fifteen used charts for analyses and eleven presented the accounts in vertical form.

TURNOVER ANALYSES.

One practice which has become quite prevalent in this country, more to counteract left-wing political ideologies than from any other motives, is the inclusion in the directors' report of a statement showing how the gross turnover has been spent—i.e. how "the cake has been divided." The information is presented in a variety of ways. Out of about 200 statements which the author recently examined the most popular

expedient adopted was to show the various outgoings as components of a £, so many shillings, pence and fractions of a penny being shown as attributable to each item, e.g. wages, salaries and pensions, raw materials, fuel and power, carriage, overhead and renewals, taxation, transfers to reserves, dividends, etc.

The method next in order of popularity was to show the percentage applicable to each outgoing. (The statement issued by Morris Motors, Ltd., and reproduced on page 357, combines both these methods of displaying the analysis.) In one instance noted, the items were tabulated in pence as shown below:—

	Pence.
Wages and salaries	84
Raw materials	85
Operating expenses	39
Taxation	15
"Ploughed back"	10
Depreciation.. ..	4
Dividend	3
Total	240 pence.

Sometimes the manner in which "the cake has been cut" is more vividly displayed in diagrammatic form—by means of shaded bars or segments of a circle, etc. In another case an illustration was employed for this purpose, three half-crowns and two pennies representing 7s. 8d. out of each £ expended on wages and salaries, and two pennies and one half-penny representing 2½d. paid in net dividends, and so on.

More elaborate presentations of turnover analysis have been seen recently, artists' drawings adding to the piquancy of the overall picture. The announcement of Tate and Lyle, Ltd., on the opposite page is an example, the touch of humour in the captions adding to the general appeal. (It will be seen in this illustration that net dividends are expressed *in relation to the standard sales unit*.)

There are one or two dangers in this practice of analysing turnover. While it may be legitimate to illustrate the meagre share of the total proceeds taken by shareholders as compared with the share taken by employees and also the disproportionate share taken in taxation by that ever-present partner,

Where all the money went in 1950



“I had a good year in 1950—a GROSS INCOME of £24,435,000 of which over £29,000,000 came from Exports—



—but housekeeping bills went up again. COST OF RAW MATERIALS, FUEL AND SERVICES reached £76,309,000



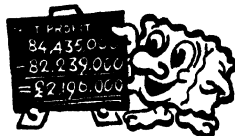
WAGES & EMPLOYEES' BENEFITS took £3,700,000 and my new PROSPERITY SHARING SCHEME another £118,000 — all money well earned.



£1,770,000 went in OVERHEADS AND SPECIAL EXPENSES which includes the money I had to spend in self-defence —



—and as time respects neither machinery nor human beings, I had to provide £342,000 for RENEWALS AND DEPRECIATION.



Even so, I still had a smile on my face —



—which the Chancellor quickly removed, together with £1,228,000 as TAXATION ON PROFITS.



Then, with an eye on the future, RESERVES were increased by £350,000 —



—which left me with £218,000 for NET DIVIDENDS TO STOCKHOLDERS, equal to one-seventh of a farthing for each pound of sugar sold. 99

We employ 8,500 work people and there are 19,000 stockholders



the State, the picture must not be over-emphasised or distorted, otherwise it loses its effectiveness. For example, if wages are shown gross, dividends should appear gross also. As the tax deducted from dividends is required in the taxation item, it is normally wise either to reveal the disproportionate elements of wages and dividends in one statement and the disparity between taxation and dividends in another, or else to show wages both before and after deduction of P.A.Y.E. A great deal depends, of course, upon the purpose for which the figures are produced.

If dividends are expressed in 1950 pounds, should not capital also be raised to current monetary values? Depreciation will normally have been calculated on capital expenditure partly at pre-war values, while much of the year's expenditure will be at current values. The remedy here is not simple, and short of preparing stabilised accounts at present-day price levels the difficulty is not easy to overcome. Some companies have experimented on these lines, but the stabilisation of accounts in order to overcome some of the problems of inflation has not had the sort of official encouragement in this country which has made the practice much more common in continental countries. There is a widespread complaint here that capital allowances for tax purposes are based on historical and not current values. (The effects of inflation on accounts are discussed at length in Chapter XV.)

There are one or two other problems, apart from the statement of turnover analysis, which merit consideration when a directors' report is being prepared.

Sometimes the difference between *subscribed* capital and capital *employed* in the business is insufficiently appreciated. If a company with an issued capital of £100,000 and accumulated reserves of £300,000 declares a dividend of 40 per cent., this is equivalent to only 10 per cent. on the capital employed.

There is another source of danger of distortion in the case of a company with a highly-g geared capital structure, where the rate of dividend expressed on equity capital is disproportionate to the earnings. One company has an issued capital of £60,150 divided into 60,000 6 per cent. £1 preference shares and 3,000 ordinary shares of 1s. each. A net return of 7 per cent. on the total subscribed capital of £60,150 may produce a dividend exceeding 400 per cent. on the ordinary shares !

These circumstances, which often give rise to distortion, may need consideration in the preparation of any statement which it is proposed to include in the directors' report, to ensure that a reasonably accurate picture of the state of affairs is presented.

The reluctance of companies in this country, with a few exceptions, to disclose the figure of annual turnover is discussed in Chapter XI. It is not always appreciated that this significant figure can usually be obtained with approximation by a simple calculation when a statement of turnover analysis is given. Thus, if depreciation (appearing in the accounts at £10,000) is stated to be equivalent to 4d. in the £ of turnover, the required figure obviously approximates £600,000.

CHAIRMAN'S SPEECH.

The chairman's speech which has been prepared for the annual general meeting is often circulated with the directors' report. This practice really commenced during the second world-war, when it was especially difficult for shareholders to attend meetings. As comparatively few members attend annual general meetings even in normal times, the practice has since become more general. Those members who are unable to attend the meeting are kept informed of the company's activities and progress, while those who do attend are better prepared to take part in the proceedings.

The circulation after the meeting of a digest of the entire proceedings, as envisaged earlier in this article, is, unfortunately, a rare occurrence in this country.

FUNCTIONS OF THE COMPANY.

It is really surprising how many companies neglect to give any indication in their report or accounts as to what the company makes, sells, or provides—and *where*! This common deficiency must be one which amazes even the most inexperienced layman.

ANNUAL GENERAL MEETING.

Opinions will differ on how far it is practicable to go to make the annual general meeting a function more likely to improve the lines of communication between the boardroom and the members. Some company executives will have no desire to attract shareholders to the meeting, but this is not the

enlightened view. It was amusing to read the report of a recent meeting, where music was played before and after the proceedings, including the tunes "Pennies from Heaven" and "The more we are together!" Humorous diagrams were fixed on the walls, explaining such expressions as "writing-down goodwill," etc., in connection with a simple description of "why does a balance sheet balance?" (What a host of fundamental problems could be covered in dealing with that question!) It is likely that the prestige of the company was enhanced by the unconventional arrangements at the meeting.

PRELIMINARY ANNOUNCEMENTS.

Another link in the chain of communication is the statement issued by public companies when announcing final dividends. The Stock Exchange has made a request that all companies whose shares are quoted should, in the absence of special circumstances, include as a minimum in this statement information as to the profit earned or the loss sustained during the year (after charging taxation), the taxation charged, *abnormal* debits or credits included in the accounts, rates of dividend(s) paid and proposed, and the net amount involved, with corresponding figures for the preceding year for the foregoing items and any other information necessary for a reasonable appreciation of the year's result. Similar information for the group is required from a holding company. Additional details in the announcement are welcomed by the Share and Loan Department.

Companies seeking a quotation are now required to furnish an undertaking that they will publish preliminary figures when announcing final dividends. This is another example of the modern trend towards stimulating closer contacts between the board and the investing public.

CHAPTER XV

COMPANY FINANCE

CAPITAL ARRANGEMENTS.

Every company, whether private or public, must decide how the necessary capital shall be obtained, and what form the capital shall take. These two problems arise at incorporation and will recur whenever additional capital is required.*

The relative advantages and disadvantages of issuing preference shares, ordinary shares, deferred shares and debentures need to be considered. Furthermore, as each of these alternative forms of capital may be of different types or possess different rights, it will be appreciated that the matter may require consideration from several angles before a final decision is made.

SHARES *v.* DEBENTURES.

The first subject for consideration is whether debentures shall be issued in addition to shares, or the whole of the capital funds obtained in shares. If it is decided to adopt the former course, the company must determine the proportion of the total sum required which is to be obtained from the issue of debentures.

In general, it may be asserted that, when a company has invested a substantial portion of its capital in lands and buildings, it is in a favourable position to issue debentures, as these assets are suitable for inclusion in a mortgage as security to

* The Borrowing (Control and Guarantees) Act, 1946, provides that the Treasury shall have power to make orders regulating, subject to such exemptions as may be specified in the orders, the issue of shares or debentures of a company.

These powers have been exercised by the making of the Control of Borrowing Order, 1947 (S.R. & O., 1947) dated May 21, 1947, which was amended as from April 21, 1949 by the Control of Borrowing (Amendment of Exemption Provisions) Order, 1949 (S.I. 1949, No. 755).

The Capital Issues Committee, which is the medium through which this Treasury control operates, is guided by considerations of the "national interest" and in close liaison with the various Government departments, controls the raising of new capital in accordance with Government capital expenditure policies.

the debenture holders. Debentures secured by a specific charge on land and buildings, together with a floating charge on the assets as a whole, usually constitute an attractive investment and will be acceptable to investors at the lowest rate of interest compatible with the company's financial standing, and prevailing monetary conditions. Fixed plant and machinery is frequently included in the specific mortgage.

The rate of interest necessary to remunerate debentures will in all cases be less than that for dividends payable on preference shares issued about the same time, and the benefit of this arrangement normally accrues to the ordinary or deferred shareholders who participate in residual profits.

Although it is inadvisable to dogmatise on this subject, a company is well advised, in the absence of special circumstances, to issue debentures up to the maximum amount which can be secured on the assets without interference with normal business. This statement is made on the assumption that the company's financial prospects appear to be adequate to meet the interest charges. This is an important point, as debenture interest must be paid whether profits are earned or not, whereas dividends on shares are automatically passed over when profits are insufficient to meet such disbursements.

Debentures issued by companies incorporated under the Companies Act are invariably of the redeemable type, and typical provisions for redemption, under which a company may be able to effect an economy in interest payments, have been already set out in Chapter X.

There are cases, however, when an issue of debentures would be undesirable, the whole of the capital required being more suitably obtained in the form of shares. Take, for example, a company formed to develop gold-mining concessions which has earned no profit since incorporation, and the prospect of net income accruing in the first few years is remote. The assets acquired will probably be of a highly specialised character and of little value in the event of enforced realisation. They are, accordingly, unsuitable as security for debentures. Moreover, debenture interest may prove a burden to the company during the period of development.

The investor in such a company would consider his contribution to the capital resources as being of a speculative character, and would be justified in regarding with disfavour

any limitation placed upon the remuneration from his investment. It is obvious, therefore, that ordinary shares are the only type of security which would meet his requirements.

The debenture issues referred to on page 168 are exceptions to this rule, but in the cases mentioned, the debenture holders had power to convert their holdings to shares on giving the requisite notice, as previously explained. This was a valuable and unusual option.

The conclusions which may be drawn from the foregoing are:—

- (1) When a company obtains a portion of its capital by the issue of debentures, the annual outlay on interest is less than would be required to remunerate a corresponding amount of share capital (i.e. when the company's operations are profitable).
- (2) Debenture interest is payable whether profits are earned or not, whereas dividends on shares may be suspended during periods when losses are being incurred.
- (3) Provision may be made for the redemption of debentures either out of profits, out of capital, or by the issue of new debentures for the purpose. Share capital is only capable of redemption in the manner described on pages 118–122.
- (4) A successful debenture issue usually demands the existence of assets acceptable to the debenture holder as security, and these assets must be unencumbered and available for this purpose.
- (5) There must be a reasonable prospect of the company being able to remunerate debentures out of current income.
- (6) When the business of the company is of a speculative character, or liable to acute fluctuations, or has not yet been established on a revenue-earning basis, the issue of debentures is ill-advised.

The advantage of issuing debentures instead of preference shares in order to reduce liability to profits tax is mentioned later in this chapter.

DIVISION OF CAPITAL INTO SHARES.

Having decided whether debentures shall be issued or not, the next matter to be settled is the manner in which the capital shall be divided.

If it is desired that all shareholders shall share equally in the fortunes of the company, the capital will be divided into shares of one class only, i.e. ordinary shares.

On the contrary, the vendors or promoters of a company may wish to reserve to themselves the right to participate in surplus profits, being willing to have their dividend rights deferred to the claims of those shareholders entitled to a fixed preferential dividend. In such circumstances ordinary shares will be issued to the vendors or promoters and the preference shares (if a public company) offered to the public for subscription.

Alternatively, the company may offer a portion of the ordinary shares for public subscription; the promoters retaining sufficient of this class to meet their own requirements. It is quite a common practice for both preference and ordinary shares to be offered to the public, under a condition whereby applicants must apply for one or more preference shares as a qualification for each ordinary share applied for; applications for ordinary shares alone not being considered. This arrangement tends to make the offer more attractive, at the same time reserving for the promoters an adequate holding of ordinary shares which they may be quite justified in securing.

The profit-earning capacity of ordinary shares in a well-financed company carrying on a prosperous business is not always fully appreciated. This feature of company finance arises to a more marked degree when the total nominal value of the ordinary capital is comparatively small in relation to the aggregate issued capital and amount of debentures outstanding.

The following concrete example serves to illustrate this point:—

The Merivale Trading Co., Ltd. has an authorised capital of £100,000, divided into 90,000 4 per cent. preference shares of £1 each, and 200,000 ordinary shares of 1s. each, all of which were issued and fully paid. Three per cent. debenture stock, of an aggregate nominal value of £70,000 had been issued by the company. The profits earned in a particular year amounted to £17,000, this figure being computed after charging all expenses, making all provisions which the directors considered necessary and such transfers to reserve as may have been approved, but before charging debenture interest. In other words, the amount of £17,000 was available for payment of debenture interest and the

balance for dividends, and would be appropriated as under:—

	£
Interest on £70,000 3% Debenture Stock	2,100
Dividend of 4% on 90,000 Preference Shares of £1 each	3,600
	5,700
Leaving available for dividend on 200,000 Ordinary Shares of rs.	11,300 (i.e. 113%)
Total	<u>£17,000</u>

It will be observed from this simple illustration that a profit of 10 per cent. on the paid-up value of shares and debentures (i.e. 10 per cent. of £170,000 = £17,000) was sufficient to permit the payment of a dividend on the ordinary shares equivalent to 113 per cent.!

If the reader cares to re-draft this example for succeeding years by taking a profit of 15 per cent. (£25,500) and 20 per cent. (£34,000) on the loan and share capital employed and again assuming that the whole of these amounts were available for debenture interest and dividends, he will discover that the ordinary shareholders will enjoy dividends of 198 per cent. and 283 per cent. respectively!

A hardship has been suffered in recent years by ordinary shareholders in a company with a highly-g geared capital on the lines of the foregoing example since profits tax at the higher rate falls on the amount distributed as preference dividends as well as on ordinary distributions and the impost falls exclusively on the ordinary shareholders. Now that the rate on distributed profits is 50 per cent. (i.e. since January, 1951), this burden is a heavy one.

Companies may well decide, when exercising the right to redeem redeemable preference shares, to issue debentures, since debenture interest ranks as a charge for profits tax purposes.

Deferred shares have not been commonly issued in recent years, a tendency being evident for promoters to allow the investing public to participate, along with them, in the deferred dividends of the company payable on ordinary shares. When, however, a small amount of deferred capital ranks for residual profits after payment of dividends on a substantial volume of preference and ordinary shares, the results illustrated above may be even more pronounced.

There is at present a strong political prejudice against the payment of dividends at what appear to be exorbitant rates and although the reactions of those representing the interests of employees (and, to a lesser degree, of consumers generally) can be well-understood and is occasionally justified on the grounds of profiteering, there is all too-often a tendency for an unduly narrow viewpoint to be held. This is usually due to misinformed impressions, but political bias is sometimes responsible.

In the foregoing example, a net profit at the modest rate of 5 per cent. (amounting to £8,500) would enable a dividend of 28 per cent. to be declared on the ordinary shares. It cannot be said that 5 per cent. on the capital invested in the business is unreasonable and the fact that ordinary shareholders can receive on this basis a dividend at a rate considered in some quarters to be excessive is due to the capital structure of the company—a structure which deprives those shareholders of any dividend whatever if anything less than $3\frac{1}{2}$ per cent. on the total capital is earned!

This argument is occasionally refuted on the grounds that all the capital of a company should yield the same income, but would this meet the needs of different types of investors? Is the investor who is willing to take the most risk—risk of capital depreciation and loss of income—entitled to the largest share in the fortunes of the company when it is successful? His claim to share in surplus profits, cannot morally be denied. Moreover, he has either acquired his shares at a premium, which will considerably discount his income, or else he has come in as a shareholder at a time when the risks of losing, not merely his income, but his capital as well, were appreciable.

The “voluntary” limitation of dividends is discussed at length later in this chapter.

ADVANTAGES AND DISADVANTAGES OF REDEEMABLE PREFERENCE SHARES.

The relative advantages of various classes of preference shares, i.e. non-cumulative, cumulative, participating, etc. have been treated in Chapter VIII. The provisions under which redeemable preference shares are capable of issue were also enumerated in that chapter, and since 1929 many companies have issued shares of this type.

Redeemable preference shares have one feature in common with debentures: their duration is limited, redemption taking place on or before a specified date. Moreover, as in the case of debentures, a company usually reserves to itself the right to redeem the shares within a stipulated period, the first and last dates of this period being prescribed at the time of issue.

The company is accordingly able to select the most advantageous date (within the specified period) for redemption, having regard to all conditions, both internal and external.

When redeemable preference shares are redeemed out of profits, the resultant capital redemption reserve fund normally belongs to the ordinary shareholders, the fund either remaining in the business or, as previously explained, distributed to the ordinary shareholders in the form of a capital bonus.

This privilege of redemption exercisable by a company may place the holders of redeemable preference shares at a disadvantage in relation to other shareholders. Circumstances may arise when such shares, in a prosperous company, are redeemed at par, or at a small premium in accordance with the provisions of issue, when they would, if irredeemable, command a capital value considerably in excess of their nominal value.

On the contrary, it must not be overlooked that redeemable preference shareholders possess a reasonable assurance that their capital will be repaid at the price determined at the time of issue, and the risk of depreciation in the value of their investment is accordingly diminished.

It will be appreciated from the foregoing that redeemable preference shareholders occupy a status between that of the debenture holders and the remaining shareholders.

CAPITAL BONUSES.

A company enjoying a prolonged period of successful trading may, in each year, strengthen its financial position, and this enhanced financial stability will be revealed in successive balance sheets. Goodwill, patents and trade marks will probably be written-off, material assets written-down on generous lines, and adequate reserves made.

In most years sums will be available, after making satisfactory dividend allocations, for transfer to a general reserve.

Cash represented by the reserve may, in turn, be expended in acquiring assets in extension of the business. When this

happens a company is said to be building up its business out of profits.

The specimen balance sheet on the next page illustrates the position of a company after a period of prosperous trading, assuming that profits have been conserved and utilised to provide extensions to its original sphere of operations.

Analysing this balance sheet we find that each £ invested in ordinary shares, on the basis of book valuations as at 31st December, 1951, is intrinsically worth £6 17s. 9d., computed as under:—

Total Assets as per Balance Sheet	£	212,800
Less Trade and other Liabilities, including Provisions		8,350
		204,450
Less Liability to Debenture holders		40,715
		163,735
Less Preference Capital		26,000
(Note.—It is assumed that the Preference Shares carry no rights to participate in surplus assets.)		
Amount belonging to Ordinary Shareholders	£	<u>137,735</u>

The amount of £137,735 is made up of:—

Ordinary Share Capital	£	20,000
Reserve Account		50,000
Profit and Loss Account Balance		67,735
		£137,735

The company may decide that a stage of its career has now been reached when the ordinary shareholders can be imbursed with some portion of their enhanced financial interest in the company. Part of the reserve, say £40,000, might be set aside for this purpose which would permit of an additional dividend to the extent of 200 per cent., or a capital bonus of 2 shares of £1 each for each share held at present.

As the amount of £40,000 (out of reserve account) is represented by capital assets, it would seem more appropriate that the disbursement should go to shareholders in capital form, and be received by them without income tax or surtax

BALANCE SHEET OF A, LTD. 31ST DECEMBER, 1951.

	£	£		£	£
<i>Authorised and Issued Capital :</i>			<i>Freehold and Leasehold Land and Buildings, at Cost ..</i>	75,000	
26,000 6% Preference Shares of £1 each, fully-paid		26,000	<i>Less Depreciation ..</i>	29,000	46,000
20,000 Ordinary Shares of £1 each, fully paid		20,000			
		<u>46,000</u>	<i>Plant and Machinery at Cost</i>	116,000	
			<i>Less Depreciation ..</i>	31,000	85,000
<i>Profit and Loss Account :</i>			<i>Fixtures and Fittings, at Cost</i>	20,000	
Balance brought forward from last year	40,876		<i>Less Depreciation ..</i>	2,200	17,800
Add Profit for year ..	28,419				
	<u>69,295</u>		<i>Investments, at Cost (market value at 31st December, 1951, £29,410)</i>		19,600
<i>Less Preference Share Dividend</i>	1,560	67,735	<i>Stocks and Contracts in Course of Execution</i>		12,440
Reserve Account ..		50,000	<i>Sundry Debtors and Amounts paid in advance</i>		16,260
4½% Debenture Stock ..	40,000		<i>Cash in Hand and at Bankers ..</i>		15,700
Add Interest accrued ..	715	40,715			
<i>Sundry Creditors, including provisions for Income Tax and Contingencies</i>		8,350			
		<u>£212,800</u>			<u>£212,800</u>

liability. This procedure, moreover, has the effect of bringing the issued capital up to a figure which is more in accord with its true value.

Against this, it must be appreciated that the suggested bonus issue will involve an increase of authorised capital, and also that dividends on the ordinary capital will, in future, require to be spread over £60,000, instead of £20,000 (a feature which has been previously treated [see page 152]).

It should be observed that the issue of bonus shares involves no disturbance of the company's assets. On the other hand, £40,000 paid in additional dividends would necessitate (in the above example) the realisation of assets, and/or obtaining temporary financial accommodation to enable the payment to be made, unless the cash balance of £15,700 showed a considerable increase when the time came to make the distribution.

An example of a bonus issue proposal will be seen in the directors' report of Marks and Spencer, Ltd., on page 369.

A formidable section of political opinion in this country is opposed to the issue of bonus shares on the grounds that profits are utilised for this purpose and dividends (being spread over a larger field of capital) are declared at more modest rates. It is alleged that the practice is employed to depress wages by hiding a portion of the profits and also as an expedient for escaping taxation, since, on liquidation of a company, repayment of capital does not attract income tax.

Instances have come to notice from time to time which appear to justify the foregoing viewpoint but, taking a balanced view, there is abundant evidence to show that directors, in all but isolated cases, act in this respect in the best interests of the company as a whole and are not actuated by ulterior motives directed against any body of persons—employees, consumers or the State.

It must be appreciated that when a company pursues over a period of years the commendable technique of "ploughing-back" profits into the business, it is inevitable that the aggregate value of real capital should ultimately exceed the nominal capital employed in the concern. This excess belongs to the shareholders and it cannot be extinguished except by the imposition of some form of excess profits tax or a legal requirement that dividends shall be declared at as high a level as possible. The Government has already recognised the undesirability of continuing the excess profits tax* and any legislation of the latter type would be the antithesis of the outlook of the school of thought which advocates the abolition of bonus issues.

From 1st January, 1951, a profits tax of 10 per cent. on undistributed profits and 50 per cent. on distributed profits is chargeable (the lesser rate being an official encouragement to conserve profits within the business).

Capital bonuses are the natural outcome of employing a prudent and progressive policy in the building-up and conduct of a successful company's affairs and to restrict bonus shares is to put a premium on financial conservation and progress.

It is a political anomaly that those who condemn capital bonuses also advocate some limitation of dividends—two objectives which are difficult to reconcile. It would seem also

*The Finance Act, 1946, fixed the date for the cessation of Excess Profits Tax as 31st December, 1946.

that no palliative could be introduced which does not stifle initiative and industrial development.

For the whole of the period of the 1939-1945 war and for some time afterwards, bonus issues had to have the consent of the Treasury which was virtually never granted. In 1947 this unrelenting attitude was relaxed but a tax of 10 per cent. was imposed on bonus issues (Finance Act, 1947).

In April, 1949, the earlier attitude was completely reversed. Bonus issues ceased to be taxable (Finance Act, 1949) and by the Control of Borrowing (Amendment of Exemption Provisions) Order, 1949, they were for the first time granted the benefit of the £50,000 exemption limit allowed to other issues. Bonus issues above this limit still required sanction of the Treasury, but this was granted with some freedom. On 24th October, 1949, however, the Chancellor of the Exchequer asked the Capital Issues Committee to suspend *all* applications for permission to make bonus issues. The reason for this decision was stated to be the need to check the evasion of dividend limitation (see pages 252-255) by the issue of free preference shares to ordinary shareholders.

A third decision was made in 1949 (December) when the Chancellor removed the "absolute suspension" and permitted bonus issues to be made provided they were necessary to enable companies to increase production or to expand exports. (It is difficult to appreciate how any capitalisation of reserves could affect either production or exports!)

Having regard to changed circumstances resulting from rearmament and other developments the Treasury issued another direction to the Committee in April, 1951, to the effect that, in making recommendations on a proposed bonus issue or an issue containing a bonus element, it should bear in mind that all of the following requirements should be fulfilled, viz., that the application relates as a single operation to the capitalisation of true reserves and is one which will benefit the stability, credit or efficiency of the undertaking; that it does not take a form which will enable tax liabilities to be reduced; and finally, that it is in the public interest having regard to the general directions to the Committee. These general directions referred to the discouragement of capital issues except those relating to the defence programme, projects to alleviate basic deficiencies, particularly of raw

materials, contributions to import saving and particularly dollar saving, etc.

It will be seen therefore, that the mechanically simple operation of re-drafting the balance sheet so that it is more in accord with the real financial structure of the company has become a political issue of some magnitude. Government policy in this connection has hardly been in harmony with the overriding "true and fair view" requirement of the Act!

LIMITATION OF DIVIDENDS.

In March, 1948, the Chancellor of the Exchequer proposed that all public companies should voluntarily agree not to pay higher ordinary dividends than they had paid in the preceding year. This was part of a comprehensive plan for checking inflation, which it was hoped would have the effect of restricting claims from organised labour for higher wages.

The various representative business organisations recommended companies to agree to this limitation, and in January, 1949, the Chancellor announced that in the eight months, April to November, 1948, the capital of companies which did not pay increased dividends amounted to 93 per cent. of the total capital involved, "and some of the small minority of companies which did vote increases had justifiable reasons for doing so, though a few had not."

While an artificial restraint of this character might have been justified by the exigencies of prevailing national conditions and not be injurious to the trade and industry of the country as a short-term measure, the indefinite prolongation of this practice has, on balance, been detrimental. It has discouraged incentive and the willingness to take risks and has operated unfairly upon equity shareholders. Prospective investors are naturally reluctant to embark upon the risks attached to ordinary shares when they offer no prospects of increased dividends.

While a compulsory "ploughing-back" of profits may be advantageous to some companies which might otherwise not reserve for future modernisation and expansion, there must usually be some limit to this, while the majority of companies normally maintain adequate reserves without official prompting. There are also a number of economic disadvantages. Capital is not attracted to those industries which need stimulation in

the national interest, and money which might otherwise be available for such industries may become clogged in less essential enterprises.

In February, 1949, the question of voluntary dividend limitation for a further year was raised and the Federation of British Industries issued a questionnaire to companies on the subject. Many companies responded with an undertaking not to increase their dividends during the ensuing year, some confined their undertaking to a policy of moderation, while a few agreed to limit dividends subject to certain qualifications. These qualifications generally implied dissatisfaction with the Government's financial policy and apprehension of the ability of the trades unions to check increases in wage rates, which proved to be justified. The most potent criticism received was directed against the Government's practice of using Stock Exchange prices, depressed by dividend limitation, as a basis for compensation when nationalising undertakings. A few companies, fearing that nationalisation would ultimately spread to the industry in which they were engaged, openly rebelled on the plea that it was grossly unfair for the Government to base compensation upon prices artificially reduced in this manner.

The F.B.I., in conjunction with the Associations of British Chambers of Commerce and the National Union of Manufacturers, gave the Chancellor an assurance of industry's co-operation "for one more year," at the same time pointing out the objection to any rigid formula which excludes exceptions where circumstances justify such a course. The criticisms voiced by companies generally were summarised, and it was also pointed out that artificial restrictions on dividend policy could only be justified as temporary expedients in exceptional circumstances.

The reply given by the Chancellor acknowledging the assurance was accompanied by a comment which lent considerable force to the apprehension felt by company executives that if they failed to agree to limit dividends, compulsion by legislation would be applied.

During the latter part of 1950 and the early months of 1951 signs of the restraint breaking down became apparent and a number of prominent companies increased distributions on equity capital. A severe deterrent was imposed by the

Government by increasing the rate of profits tax on distributed profits from 30 per cent. to 50 per cent. as from January, 1951 (Finance Act, 1951).

In reply to a question in the debate in the House of Commons on the Finance Bill, 1951, Mr. Gaitskell stated that the increase in the tax on distributed profits did not mean that the Government were indifferent to increases in dividends and he gave the warning that if the policy of moderation and restraint were abandoned, further action would have to be considered.

The threat of compulsion descended in concrete form on 26th July, 1951. In introducing to the Commons the Government's programme designed to meet the prevailing economic crisis, exemplified by the steep increases in price levels, Mr. Gaitskell, the Chancellor of the Exchequer, announced the plan for a three-year control of dividends.

The Bill, which it is the Government's intention to introduce in the autumn of 1951, will impose a limit *on the gross amount of the dividends which may be distributed*, other than fixed-rate dividends. The normal limit will be *the average distributed for the last two accounting periods for which a final dividend has been declared before 27th July, 1951*. Companies that have paid no dividend, or an abnormally low rate, may pay 5 per cent. on the paid-up share capital, and for new companies, which may need to raise more capital, the limit will be 7 per cent.

Control will apply to public and private companies, *but not to those distributing less than £10,000 gross*.

The Treasury will be given power to permit higher dividends in "very special cases," but the Chancellor stressed that in the great majority of cases the dividend standards provided must be regarded as adequate.

The proposals were undoubtedly a gesture to the trade unions in an attempt to suppress further increases in salaries and wages. Mr. Gaitskell admitted that the psychological effect of dividend increases was far greater than their direct monetary impact.

Whether the Bill will become law and, if so, to what extent its contents will be amended, is not known at the time of writing.

The issue is, of course, largely a political one, and opinions are divided according to whether profits are considered to be a social evil, or conversely, whether they are an essential

incentive to increased production and trade and an alternative to the bureaucratic state.

The Management Accounting Team, which visited America in 1950 under the auspices of the Anglo-American Council on Productivity, drew attention to the difference in outlook of the American workman and his trade unions from the one to which we have become accustomed in Britain. In this country large profits are looked upon in certain quarters as a social evil; in America the workman appreciates that his earnings are closely correlated with his employer's profits. Wage agreements are made with individual concerns rather than on a national basis as appertains in this country, and those undertakings which, owing to inadequate profits, are unable to pay wages at the same level as their competitors, are encouraged by the unions to investigate their organisation by co-operative enquiry and, if necessary to avail themselves of the business consultants made available by the unions.

Dividend limitation, of course, causes much equity capital to be quoted at values which are out of line with the earning power of the companies concerned. The effect of this is that if these companies wish to issue ordinary or deferred shares they are compelled to do so at inordinately low prices and, therefore, to "water" their capital in a manner prejudicial to existing shareholders.

In the matter of finance, companies are at present caught both ways! On the one hand, the issue of equity capital is prohibitively expensive and on the other hand, as already pointed out, the high incidence of profits tax makes it desirable to reduce the gearing of the capital structure by the issue of ordinary shares rather than to increase it by the issue of priority capital.

THE EFFECTS OF INFLATION ON ACCOUNTS.

A fundamental problem of company finance and perhaps the most controversial issue in recent years is that relating to the effects of inflation on accounts in general and profit ascertainment in particular. Many economists have been loud in their condemnation of the continuing practice of confining annual charges for depreciation to debits based on the original cost of assets purchased at prices considerably less than those prevailing to-day. They draw attention to the indisputable

anomalies contained in the revenue figures of most undertakings which are a mixture of pounds, some representing values of the year under review and some representing the vastly different and varying values of previous years.

The inevitable over-statement of profit which results can be illustrated by taking a simple example of an article produced by the use of plant which originally cost £10,000 but which is incapable of replacement to-day at less than £25,000. The cost and the profit as determined by existing practice might be:—

		£	£
Proceeds of sale	.. ..		630
Direct Labour and Materials	..	300	
Charge for use of plant	.. ..	100	
Overheads, establishment and general expenses.. ..	.. ..	150	
			550
Profit	.. ..		£80

The charge for use of plant, being the appropriate proportion of depreciation provided which is applicable to this particular job, is based on the first cost of plant, i.e. £10,000. If depreciation had been provided at replacement costs, the charge for use of plant would have been £250 instead of £100 and the profit of £80 would have been converted into a loss of £70! (It is possible that the loss would have exceeded £70 as the replacement cost basis of accounting might increase the overheads to a figure slightly above £150).

It will be seen that the total cost of £550 is made up partly of current expenditure and partly of past expenditure which is now being absorbed into revenue in the course of normal operations. The effect is that a volume of capital consumption is "dressed-up" to look like income.

If each of the assets in a balance sheet is valued in pounds of the purchasing power current when the asset was acquired, the totals of the balance sheet may easily be meaningless.

It is probable that something like one-half of the amounts nowadays shown as free reserves by British companies are not really free. A financial journalist recently estimated that profits since 1939 have been over-stated to the extent of £1,500 millions for plant and £1,000 millions for stocks. Although these are doubtless very broad estimates, the extent

to which taxation has been suffered on such so-called profits will be appreciated.

The British Bankers' Association recently conducted an investigation into the balance sheets of some 1,500 companies with an aggregate capital of about £2.5 million. This enquiry demonstrated that, between 1946 and 1950, this sample of industry suffered a fall in cash holdings and marketable securities and, on the other hand, appreciably increased its bank overdrafts.

The amounts invested in stocks of materials, etc., doubled over this period, not, the Bankers contend, due to any quantitative increase in physical stocks, but on account of increased prices and at the cost of severely straining industry's position.

When the monetary unit fluctuates almost from day to day, it is almost impossible to measure values with any degree of accuracy. It is like endeavouring to measure the size of one's front garden with a tape measure which shrinks during the process.

The replacement of assets at increased costs (where depreciation has been provided on the basis of original costs) involves either (a) drawing upon reserves or (b) raising fresh capital to repair the inroads of inflation. It has been a common complaint of company chairmen for some years that the first alternative necessitates setting aside out of profits such sums as will, *after they have been stripped of taxation at its existing exorbitant levels*, be requisite for the purpose, while the second alternative calls for fresh issues of capital when the market may be depressed by the incidence of dividend limitation.

This problem is not by any means confined to fixed assets. The replacement of stocks at increasing price levels and the burden of carrying greater volumes of debtors and liquid assets owing to the diminishing value of the pound necessitates the employment of a larger capital as measured in terms of the standard monetary unit. (One well-known company recently had to find another £20 million to finance stocks alone, this sum being provided by the issue of £20 million of unsecured loan stock). Reference to the balance sheets reproduced in Appendix B will give some indication of the steep rise in the value of stocks within the space of one year.

The accountancy profession has in general been unwilling to depart from conventional concepts in profit ascertainment and, while fully recognising dangers in the present position, has

adopted what has perhaps been a realistic approach to the difficulties and hazards of departing from orthodox principles.

In January, 1949, the Council of the Institute issued a memorandum containing recommendations on "Rising Price Levels in Relation to Accounts." This recommended that amounts reserved for the financing at higher price levels of replacements of fixed or current assets should not be treated as provisions which must be made before profit for the year is ascertained, but as transfers to reserve. That is to say, while depreciation provisions on the basis of normal historical costs will continue to be charged before ascertainment of profit, additional amounts set aside as a matter of financial prudence to meet replacements at enhanced prices should be regarded as reserves, and, to indicate that such profits are not available for distribution, they should normally be treated as specific *capital* reserves. Moreover, it was advocated that the amount set aside for this purpose should, if necessary, be so described in the profit and loss account so as to indicate that it is not a charge against profit but an appropriation of the revenue surplus.

(When replacement of assets takes place with the aid of capital reserves current revenue will be relieved of the burden of enhanced costs, so it will be seen again, as pointed out on page 142, that amounts set aside to reserves—revenue or capital—will not, in the long term, diminish available profits).

This pronouncement of the Institute is in line with official policy in America. In December, 1947, the Committee on Accounting Procedure of the American Institute of Accountants (Research Bulletin No. 33) said: "Depreciation should continue to be based on cost; provision for replacement is a financial problem which managements will properly recognise by making annual appropriations of income or surplus."

While the economist is mainly interested in the effects of the finances of companies upon the national economy as a whole, the accountant and the business man are concerned, more domestically, with the fortunes of the individual company, and in particular with the interests of shareholders, debenture-holders and employees, and the standing of the company in the eyes of creditors and customers. However attractive it may be in theory to follow the economic concept of profits, it is probable that the disadvantages of such a policy outweigh the advantages.

Although the conflict of opinion would appear to be between economic principles and the more practical financial approach to the problems involved, i.e. between the economist and the accountant, arguments can be advanced against replacement accounting at the economic level. Any attempt to maintain real capital intact by increased charges to revenue would inevitably encourage the manufacturer or trader to seek increases in prices of his products in order to recoup at all events part of the current revenue burden. While the ethics of such increased charges may be sound from the angle of the individual business, the extra twist thereby given to the inflationary spiral would tend to enlarge the scope of the problem itself.

Again, the economist may take exception to the benefits of replacement accounting falling solely to equity shareholders (which normally would be the case). And if such equity shareholders were further relieved of the ravages of inflation by the introduction of tax allowances on a replacement cost basis, it might reasonably be asked whether other investors, including holders of government securities, should not be similarly favoured.

It is of interest to reflect upon the claims of fixed interest bearing securities. Accounting at replacement costs as distinct from orthodox accounting does nothing to cushion inflation for such investors. Advocates of the former might consider whether they would support the action of a company which deprived preference shareholders of dividend in order to provide extra resources for replacement! The effect would be that the preference shareholders, having lost a portion of the capital value of their investments as a result of inflation, would be deprived of their income in order to ensure that the real value of the ordinary shareholders' investment was maintained.

The burdens of increased prices fall broadly on all sections of the community and to confer immunity upon any one group is difficult to justify at the economic level. It is, however, contended in some quarters that replacement accounting benefits, not merely holders of equity investments, but industry as a whole, upon which the well-being of all classes of the community depends.

Our neighbours, the French, have gone some way towards relieving industry of taxation on profits employed for

re-equipment purposes. Not only has a system been put into practice in France of allowing tax relief for increased costs of fixed assets and stock replacement, but businesses are encouraged to restate balance sheet items in current monetary units, as being a condition of these reliefs. The revaluation laws do not compel the taxpayer to revalue his assets, but they lay down the maxima according to scales of coefficients introduced periodically.

Attempts are made in this country from time to time to prepare revalorised accounts as a supplement to the normal accounts, each item therein being revalued at current price levels. These reconstructed statements reveal the proportion of profits attributable to rising prices and give directors some idea of the measure of any reserve required to meet enhanced replacement costs and increased working capital.

The mechanics of producing revalorised accounts are not new. The valuation of an undertaking or part of an undertaking for sale negotiations and statements of assets for insurance purposes have always been prepared on the basis of current values.

The initial allowance for income tax purposes, which was increased from 20 per cent. to 40 per cent. in 1949, has gone some way towards bridging the gap between costs of replacement at current price levels and depreciation provided on the basis of historical costs. This alleviation (which was never any more than an interest-free loan from the State) ceases, except as stated on page 43, in April, 1952.

It has been contended that until the accountancy profession has recognised the need for presenting assets in accounts at current monetary values there is remote possibility of persuading the legislature to base calculations for tax purposes on the new values.

The Millard Tucker Committee on the Taxation of Trading Profits, which issued its report in April, 1951, took a certain degree of refuge in the fact that the Institute, while strongly advocating taxation relief to industry for increased replacement costs, had made recommendations (as already mentioned) that amounts set aside to finance replacements (whether of fixed or current assets) at enhanced costs should be treated, not as a deduction in computing profits, but as an appropriation of profits by transfer to reserve.

The official line taken by the profession was not, however, the predominant factor in influencing the Committee to recommend against some relief from taxation on asset replacements. The report* advances a number of weighty arguments in support of its conclusions.

The Committee considered that any such relief granted would give preferential treatment to the owners of businesses as against other classes of taxpayer. The report reads:—

“The non-trader who saved a sum of money before the war and invested it in Government securities or other fixed interest bearing securities finds that it is now worth in terms of real value a half or a third of what it was worth when he invested it, but he remains liable to tax on the full income from that and other sources; he does not get, and could not be given within the framework of the existing income tax system, any allowance for the loss of capital or income.

The pensioner who draws his pension from a superannuation fund to which he has contributed over his working life may find that the real value of his pension is far less than the real value of the contributions that he and his employers have made.”

In considering proposals for “revalorisation,” (i.e. the revaluation of fixed assets by reference to current prices for the purpose of determining the amounts on which annual allowances and balancing allowances are given), the Committee put forward the following arguments against the adoption of such a practice:—

- (1) A theory which in effect seeks to compute profits for tax purposes, not in terms of pounds, but of some abstract unit unspecified, raises difficulties, since a substantial part of wear and tear already allowed has been in undepreciated pounds. (The remedy here, that, as an alternative, reserves set aside for enhanced replacement costs should be insulated against the fall in the value of money, by being afforded relief from taxation, was rejected by the Committee.)
- (2) That revalorisation schemes benefit an established or “stationary” business, but not a new one or any

* Report of the Committee on the Taxation of Trading Profits. Cmd. 8189. H.M. Stationery Office, 3s. 6d. net.

expansion of an existing one. The report makes the observation:—

“The taxpayer who started business after the war has to finance the whole of his expenditure on fixed assets at present prices either by borrowing or by saving out of taxed income; the man who acquired fixed assets before the war would, however, be allowed to finance part of the cost of replacing those assets out of tax-free profits. It is true that the latter may have had to provide the same amount of wealth measured in terms of real value; for though in terms of pounds he may have provided only half as much, the pounds which he provided when he bought the assets before the war were worth twice as much as the pounds which the post-war business has provided. But we cannot accept the view that the owner of an existing business who saves to replace his plant is entitled to preferential treatment over a taxpayer who does not at present carry on any business, but is saving to set up in business.”

- (3) Revalorisation schemes give relief to the business that has not replaced its plant since the war, but not to the business which has.
- (4) Practical difficulties of determining the date of purchase and the cost of assets, including the dates and amounts of capital additions, might prove in practice to be formidable. The Committee considered that records would often not be available and when they were, the volume of work involved both to taxpayers and their accountants in preparing computations and to Inland Revenue staff in checking and agreeing them would be tremendous.
- (5) Revalorisation would give a substantial allowance for obsolete plant which, although kept in being for emergencies and as a stand-by, was not in continuous or regular use. Again quoting from the Report:—

“The extent to which any plant of this kind is retained is likely to depend on whether a particular business is short of space, and the relief would give a quite unjustified benefit to the owner of a business who, on buying new machinery, had, either from

inertia or some other cause, refrained from actually sending obsolete machinery to the scrap heap."

Many readers will disagree with some of the foregoing conclusions of the Committee and will consider the rejection of the various proposals advanced by witnesses to be disappointing. Such disappointment will not be mitigated by the alternative proposals in the Report to extend and increase initial allowances, since within a few days after the publication of the Report, the Chancellor, in his budget speech, announced the proposal to suspend initial allowances in April, 1952!

Despite all the criticisms levelled against suggested remedies, there is no doubt that industrialists and accountants are concerned at the over-statement of profits due to price increases and the burden of taxation borne in consequence. Several industrialists have recently voiced apprehension that the profit and loss account does not fulfil one of its main purposes, i.e. to show directors and shareholders the amount available for distribution and expansion of business as a result of operations during the accounting period *without encroaching upon the assets of the company*. Some reform, in their opinion, is therefore called for.

This conception of profit was well expressed by the Council of the Association of Certified and Corporate Accountants in a memorandum submitted to the Royal Commission on the Taxation of Profits and Income in the following terms, and quoted in the House of Commons in June, 1951, during the debate on the Finance Bill:—

"a sum which, at the end of a given period a business unit could dispose of without impairing the aggregate of physical assets in the same workable condition as they were at the beginning of the period."

It is of interest to mention that the greatest industrial company in this country, Imperial Chemical Industries, Ltd., recently revalued its manufacturing assets and those of certain of its wholly-owned home subsidiaries on the basis of costs of acquisition or construction current on 1st January, 1950, reduced so as to take account of the age of the assets and their probable remaining useful lives.

The result of the decision to adopt these new valuations will be seen in the balance sheet on pages 358–359. The capital reserves of the company were increased by an amount equal

to the surplus of the revised values over net book values. This surplus, amounting to £96,120,273, was credited to capital reserves in two separate portions. £58,227,768 was included in the general section of capital reserves as representing the aggregate amount of depreciation, etc., provided in the past and now freed by the valuation and the residue, i.e. £37,892,505, being the excess of the total surplus over the amounts freed in respect of amounts written off in the past, was included under a separate heading of capital reserves.

The immediate effect of the change of practice was that the charge for depreciation in 1950 was considerably heavier than that in 1949.

The directors pointed out that depreciation calculated and charged in this manner, although sufficient to write off the manufacturing assets over their remaining lives, was inadequate to provide the total cost of replacement since the cost of the assets in a new condition is considerably in excess of the revised book values adopted, as representing their present values in their partly used condition (often referred to as the "unexpired replacement value"). The amount of reserves necessary to make good the *full* costs of replacement cannot be determined because the level of prices at the various future replacement dates is, of course, not known.

The directors therefore supplemented the depreciation charge on the new basis by an additional capital reserve styled "Reserve for Obsolescence and Replacement of Assets" and this account was inaugurated by an appropriation from profits in 1950 of £5,000,000. It will also be seen in the balance sheet on page 358 that a further £4,000,000 was appropriated to the revenue reserve, "Stock Replacement."

These operations represented an innovation in company finance and it remains to be seen to what extent it is followed by other companies. There may in future be more tendency to disclose a "true and fair view" *measured in terms of present asset values*, as being a more realistic statement of the financial position.

One of the disadvantages inherent in this practice is that a revaluation—up or down—is called for each year and the view is generally held that financial conditions are not sufficiently stable to justify an operation of this character.

At the I.C.I. annual meeting the chairman stated that the directors were desirous of writing-up the company's capital

as well as the assets so that "realistic figures for assets should be matched by realistic figures for capital." Application was made to the Capital Issues Committee for permission to capitalise a substantial part of the increase in reserves, but the proposal was rejected.

The foregoing summarises the official and influential views that have been voiced and the main developments that have arisen up to the time of writing as contributions towards solving a current problem which goes to the very core of company finance. It is not easy to sum up the position as it rests to-day; not only is the conflict of opinion on the subject so sharp and irreconcilable, but the arguments advanced, both by the advocates of replacement accounting on the one hand, and by the "orthodox school" on the other are, to a considerable extent, irrefutable. Moreover, the general position to-day as it affects companies is liable to undergo changes from time to time in the light of economic developments, both domestic and international, and the extent to which orthodox accounting will weather the storm of economic events cannot be envisaged.

There is no doubt that the main difficulty in resolving this serious and acute problem is the impossibility of foreseeing future economic and political conditions. If it could be anticipated that the present level of costs would remain reasonably static for a decade nearly all the sting would be removed from this industrial sore, since a once-for-all revalorisation would stabilise the financial structure of a company for a worth-while period. This is, of course, mere "wishful thinking" and its mention serves only to focus the main dilemma.

On the one hand the view is held that industry has no legitimate claim to be insulated against the ravages of inflation, and on the other hand, it is contended that unless something is soon done to correct the over-statement of profits which inevitably results from conventional accounting, the life-blood of our national industrial resources will be sapped.

OVER-CAPITALISATION.

A company is said to be over-capitalised when a portion of its capital resources is not properly remunerative, and the consequence of this state of affairs is that dividends on the ordinary or deferred shares are adversely affected. In an acute case, preference dividends also may be jeopardised.

A common cause of over-capitalisation is the pursuance of an

imprudent policy over a period of years in the matter of capital and revenue allocations. This can be exemplified by taking an isolated example, typical of the type of accounting problem frequently arising in the course of practice.

A road transport company decides to construct, at a total cost of £500, a waiting room at the roadside for passengers. This building is a fixed asset which may be capitalised and the cost written off over the period of its life. This procedure is quite in accord with accountancy principles, whether in fact the facility which is being provided for the comfort of passengers actually increases traffic receipts or not. But the company may adopt a more conservative policy and apply the test: "Does the expenditure definitely increase revenue?" If so, it should be capitalised, but if the answer is in the negative, the amount will be more prudently written off to revenue.

The same situation arises when legal charges or compensation to existing tenants are paid on the construction of new premises. This expenditure, being part of the cost of new works, may legitimately be capitalised, but to obviate loading capital expenditure with charges which are unlikely to be remunerative, such debits may be written off to revenue, either in one year or spread over a few years.

The policies adopted by companies in making allocations as between capital and revenue expenditure vary considerably. Some companies rigidly adhere to theoretical accountancy principles; in short, all expenditure on assets employed for the purposes of the company are capitalised. At the other end of the scale, many companies closely scrutinise such costs to ensure that all capital expenditure which is unlikely to "pull its weight" in the earning of income is written off to revenue.

Between these two extremes are varying degrees of prudence in the matter of policy so far as debits to capital are concerned.

The cumulative effect of augmenting the book value of fixed assets without reference to the potential earning capacity of such charges inevitably gives rise to a lower net profit when expressed as a percentage of total issued capital than would otherwise be the case.

Other causes of over-capitalisation are:—

- (a) When assets which have ceased to be capable of remunerative service to the company are allowed to remain in the books instead of being written off.

- (b) Neglect to provide adequate depreciation.
- (c) Excessive valuations attached to certain assets, e.g. goodwill, patents, development expenditure, concessions acquired, etc.

UNDER-CAPITALISATION.

This condition may be analogous to over-trading, or made evident in other ways.

When the capital of a business is disproportionate to the volume of its operations, expenditure is liable to become unduly heavy in relation to gross receipts. Goods cost more to buy when extended credit is demanded by financial exigencies; bank charges and loan interest payments expand, and embarrassment occurs when estimates are prepared for large contracts or when attractive opportunities for new business arise. The ultimate outcome of over-trading, if continued for a considerable time, may indeed be the liquidation of the company.

Other evidences of under-capitalisation are:—(a) substantial unsecured loans outstanding at comparatively high interest rates, and (b) inadequate or out-of-date plant, equipment or buildings, causing production to be uneconomic.

The remedy for insufficient capital is, of course, the creation of additional shares, or issue of debentures. That this cure is not always capable of prompt application may be due to several causes.

Private companies are precluded from making any public issue of capital and may be unable to attract additional funds from existing connections. Conversion to a public company may seem to be the obvious course, but even then a public issue may be too expensive, or may be undesirable if the company's record of profits for the preceding years is unsatisfactory.

A company is unable to issue shares at a discount unless it can satisfy the provisions of section 57, which may preclude it from obtaining the desired capital when its existing shares are quoted below par in the market.

In such circumstances reconstruction offers an alternative, unless amalgamation with another company is considered preferable.

Reconstruction involves the formation of a new company to take over the entire undertaking of the existing company.

The capital of the new company can then be designed so as to meet future requirements of the business.

It must be remembered, of course, that the sanction of the Capital Issues Committee may be necessary before new capital is issued.*

* See footnote at page 241.

CHAPTER XVI

CRITICAL ANALYSIS OF PUBLISHED ACCOUNTS

TYPICAL ACCOUNTS ANALYSED.

To be able to form a considered judgment of a company's financial position and prospects from the information contained in its published accounts is a valuable aptitude, and one well worth cultivating. The faculty for reading and understanding balance sheets is an art which may be developed only after considerable practice and experience, and cannot be acquired from text-book reading alone.

It will be helpful, however, to indicate the general method of "attack" when dissecting a given balance sheet and ascertaining from it the maximum amount of information concerning the company's position and finances.

All the items which normally appear in the published accounts of limited companies have been dealt with in detail in previous chapters, together with some general principles of company finance. Equipped therefore with this knowledge, we are in a better position to discover what lies behind the figures appearing in the documents before us.

A word of warning is perhaps necessary before proceeding further. The limitations of a balance sheet were emphasised in Chapter II, and we must not therefore expect to glean all the information we require from this single document. The corresponding statements relating to as many previous years as possible should be available for reference and comparison, and use should also be made of the profit and loss account attached to each.

As already stated, profit and loss accounts are now much more informative than in the past and it is accordingly easier to determine the financial position and possibilities of companies from published accounts. Moreover, some of the defects of present-day profit and loss accounts (referred to on pages 189-190) will doubtless disappear as times goes on. The inclusion in profit and loss accounts and balance sheets of

balance sheet under review, these claims may, at a subsequent date, be deferred to those of secured creditors, as will be explained later.

The balance sheet now presents the following appearance:—

BALANCE SHEET (No. 1b).

	£	£		£	£
<i>Authorised Capital:</i>			<i>Fixed Assets:</i>		
300,000 Ordinary			Freehold Land and		
Shares at £1 each	300,000		Mineral Rights, at		
			Cost	286,000	
<i>Issued Capital:</i>			Buildings, at Cost,		
280,000 Ordinary			less Depreciation	28,460	
Shares of £1 each,			Plant, Machinery		
16s. per Share			and Tools, at		
paid up ..	224,000		Cost, less Depre-		
Reserve Fund ..	27,500		ciation	22,900	
Profit and Loss Ac-					337,360
count	51,000		<i>Investments, at Cost</i>		
		302,500	(market value,		
4% Mortgage Deben-			£26,426) ..		25,000
ture Stock ..	125,000		<i>Net Current Assets:</i>		
Unclaimed Dividends	240		Stock	54,000	
			Cash in Hand and		
			at Bank	11,380	
					65,380
					£427,740
					£427,740

BALANCE SHEET (No. 1c).

	£	£		£	£
			Freehold Land and		
			Mineral Rights ..	286,000	
			Buildings	28,460	
			Plant, etc.	22,900	
					337,360
Issued Capital ..	224,000		Less Mortgage		
			created	125,000	
					212,360
Reserve Fund ..	27,500		Stock	11,640	
Unclaimed Dividends	240				224,000
Profit and Loss Ac-			Investments ..	25,000	
count	51,000		Stock	42,360	
		78,740	Cash	11,380	
4% Debenture Stock	125,000				78,740
			Fixed Assets, as		
			deducted above ..		125,000
					£427,740
					£427,740

The items on the liabilities side comprise the amounts due to shareholders (in respect of capital and profits) and debenture holders. To satisfy these obligations, the assets listed on the right-hand side are held by the company, and an attempt will be made to re-draft the balance sheet so that it shows which particular assets we may regard as being available to meet the respective claims (see Example 1c on previous page). It is assumed that the mortgage debentures are secured by a fixed charge on freehold land and mineral rights, buildings and plant, machinery and tools, together with a floating charge on the assets as a whole and the uncalled capital.

It will be seen that approximately 95 per cent. of the shareholders' capital is represented by fixed assets, the balance of £11,640 being appropriately attached to a portion of the stock. The capital security therefore is dependent upon the fixed assets realising their book values. In this particular example the fixed assets consist mainly of freehold land and mineral rights, which may realise only a small proportion of their book valuation in the event of an enforced sale, and depend for their value upon the capacity of the business to employ them remuneratively in its operations.

The stock figure, at £54,000, appears to be high in relation to the other assets. There may be a good reason for the company maintaining a substantial stock in a period of rising prices and restricted supplies, but conversely large stocks may have accumulated in consequence of limited markets, which may necessitate sales at deflated prices to clear the materials. An explanation of this item by the directors would seem to be of vital interest to members.

It is apparent therefore that the shares are of a speculative character, and their intrinsic value depends entirely upon the company's progress in the future. In this connection it is satisfactory to note that profits earned to date, and undrawn (i.e. the reserve fund and "carry-forward"), are equivalent to over 35 per cent. of the issued capital. If the published accounts of recent years show that dividends have not been starved to accumulate these profits, the prospects for the future, so far as the shares are concerned, would appear to be reasonably good.

If, however, dividends have been meagre or non-existent, the outlook may be largely a matter of conjecture, and we shall expect to find the shares quoted in the market at a discount.

It must not be overlooked that, if the land and mineral rights and the stock contract in value in the future, this depreciation will cause a reduction in the real value of the shares. For example, if the depreciation of these two assets becomes equivalent to 50 per cent. of the present book valuations, the intrinsic worth of the shares, when measured in terms of asset values, will fall to approximately 9s. 6d. each, as under:—

	£	£
Share Capital (280,000 Shares of £1 each, 16s. per Share paid up)		224,000
<i>Less Capital Losses:</i>		
Freehold Land and Mineral Rights ..	143,000	
Stocks	27,000	
		170,000
		54,000
<i>Add Undrawn Profits</i>		78,740
280,000 Shares at approximately 9s. 6d. each		<u>£132,740</u>

We will now turn to the debenture-holders' security. This comprises a mortgage on fixed assets valued at £337,360, so that the debenture stock (£125,000) is covered over two and a half times and the fixed assets would need to suffer depreciation to the extent of over 60 per cent. to endanger the security afforded by the mortgage. In addition to this margin the debenture holders possess a floating charge on the remaining assets (£90,380) and uncalled capital (£56,000). We may feel satisfied therefore that the debenture stock is adequately secured.

The debenture holders' security is actually slightly greater than has been indicated above, since the debts of the trade creditors were, for convenience, eliminated at the outset of our analysis, whereas the claims of all unsecured creditors would, in practice, be deferred to those of the holders of mortgage debentures.

A balance sheet of a different type will now be reviewed, that of Morris Motors, Ltd., on pages 352-353. After the creditors and debtors have again been cancelled out to cash, the balance sheet appears in the form illustrated on the next page.

Although the financial position exhibited in this balance sheet is most satisfactory liquid resources are low. Most

industrial companies are nowadays finding it difficult to finance replacements of fixed assets and stocks. The current liabilities and provisions (£16,615,570) are double the liquid resources (£8,302,231), but due to the formidable figure for stock and work in progress, current assets exceed current liabilities and provisions by over £8 million.

It will be observed that out of the total net assets of £18 million, stocks at current values amount to no less than £16 million, a state of affairs which is indicative of present-day trading conditions and reflects the greatly increased cost of raw materials.

The preference capital is covered more than six times by net assets which are, in accordance with customary practice, included in the balance sheet at book values considerably below current values. (The interesting innovation introduced by Imperial Chemical Industries, Ltd. of revaluing fixed assets at unexpired replacement costs is referred to on pages 263-265.)

If we turn to the security afforded shareholders, we find that the position here is most satisfactory. Shareholders' Funds aggregating £18,402,807 are represented by assets in the following proportions:—

	£	%
Goodwill, etc.	Nil	Nil
Fixed Assets	9,178,990	49.9
Investments	1,136,481	6.2
Net Current Assets	8,087,336	43.9
	<u>£18,402,807</u>	<u>100.0</u>

The inclusion of Goodwill, Patent Rights and Trade Marks at £1 have been cited in previous chapters as an example where Goodwill, etc. is, for all practical purposes, written off so as to create a substantial reserve. It will be noticed that the cost is shown at rather more than £1½ million.

This is an example of what was, until 1948, a secret reserve, but is now disclosed in the balance sheet.

It is apparent from this writing down of goodwill and the normal inclusion of fixed assets at book values, that the actual financial position is better than that indicated by the balance sheet figures.

By calculating the intrinsic value of the Units of Ordinary Stock on the lines explained on page 249, we find that

each 5s. unit is worth approximately 29s., computed as shown below:—

Value of Capital	Assets	representing	Ordinary	£
Value of Profits	..	..	..	2,650,000
	Assets	representing	Undrawn	
	..	..	..	12,752,807
10,600,000 Units	..	..	..	<u>£15,402,807</u>
				29s. od. per Unit.

When it is mentioned that shortly after the issue of this balance sheet, these Units were quoted in the market at about 40s. od., it will be appreciated that the foregoing assumption as to the true financial position was endorsed by the market generally.

Some useful ratios calculated on the figures in these accounts are shown later in this chapter.

THE PROFIT AND LOSS ACCOUNT.

The profit and loss account is a valuable connecting link between one balance sheet and the next and, as pointed out in Chapter II, gives an indication of some of the causes of changes which have taken place as between two successive balance sheets. An effective analysis of the profit and loss account is, however, often difficult owing to two major defects in the account normally found in practice. Firstly, it is not customary for the figure of turnover to be shown and secondly, the information disclosed in the account is usually confined to the bare requirements of the Act, no details being given of such items as purchases, rent, wages, insurance, etc. A further difficulty arises owing to inconsistencies in practice as between one company and another in the process of determining net revenue. These matters have all been discussed in previous chapters.

Such problems do not arise when one has the opportunity of examining the full trading or manufacturing and profit and loss account prepared for internal use. These accounts and the corresponding interim accounts and statements prepared at regular intervals for the use of the management are designed to reveal as much information as possible relative to the revenue transactions of the company. The examination of such accounts is, however, outside the scope of this chapter.

Despite the foregoing limitations in published revenue accounts, it is nowadays possible to make some effective use of the profit and loss account when analysing balance sheets (even if the conclusions reached must, of necessity, be treated with some reserve), whereas prior to 1948 published revenue accounts were almost valueless for the purposes of any analytical survey of a company's financial position. The profit and loss account can be used in conjunction with the balance sheet to obtain the following information:—

1. Interest derived during the year on each group of investments, i.e. trade investments, quoted securities, and unquoted investments.
2. Income or expenditure of an exceptional or non-recurrent nature, so that any isolated "windfall" or, conversely, abnormal financial burden, can be disregarded in assessing probable future net income.
3. Variations in the ratio of provisions and reserves for replacement to the book value of assets as compared with the previous year.
4. Variations in other provisions due to current conditions, circumstances or policy which may contribute to fluctuations in profits.
5. The measure of taxation charged in the accounts and how this is arrived at.
6. The extent of the burden of loan interest, if any.

In Chapter XIV we considered the now growing practice of appending to the accounts a statement of *turnover analysis* in order to show under classified headings how the gross proceeds derived from operations have been disbursed. When the profit and loss account of a company is supplemented by a statement of this kind useful comparisons can be made as between one year and another and also as between one business and another engaged on similar functions, since expenditure is broken down into suitable components. When comparing two businesses, however, variations in the "slice of cake" taken by a particular expense or appropriation may be due to some special circumstances or conditions present in one of the businesses and not in the other which, unless known, may lead to false conclusions. To a lesser degree the same may apply when comparing one year with another of the same company, e.g. a marked advance in labour rates during the year would

normally increase the *proportion* expended in wages in that year; the acquisition of more expensive premises may similarly distort the "slice of the cake" attributable to general expenses, etc. Unless changes of this kind are known and appreciated wrong conclusions may be drawn from the figures. A useful innovation in connection with statements of turnover analysis would be to show the corresponding figures for the immediately preceding year as is compulsory in the case of the accounts. The attention of the reader has already been drawn to the fact, so often overlooked, that the approximate gross turnover can readily be calculated from such a statement. This is particularly helpful when making an analysis of the accounts, since certain additional comparative ratios can be calculated when the turnover is known.

ACCOUNTING RATIOS.

When applying any critical analysis to the published accounts of companies, the calculation of appropriate ratios is often helpful, but it must be appreciated that the significance of such ratios may be dependent upon a number of factors, some of which may not be known, and the conclusions drawn must accordingly be regarded as subject to certain assumptions. It is also advisable to endeavour to verify by other means whenever possible any conclusions reached from the study of ratios, as this will often necessitate some modification of an assumption or even its rejection. Even a series of ratios for one company or parallel ratios for a number of companies engaged in the same type of activities need to be considered in conjunction with such circumstances and conditions as are disclosed in accounts, directors' reports, chairman's speeches, etc., before any conclusions drawn from the calculations can be regarded as positive.

To deal adequately with this subject of accounting ratios would require an entire book, but the main formulae are referred to below and, by way of illustration, relevant figures have been taken from the consolidated accounts of Morris Motors, Limited, already analysed in this chapter. The accounts are reproduced on pages 352-357.

$$\begin{aligned}
 (a) \quad & \frac{\text{Net Profit minus Preference Dividend}}{\text{Ordinary Capital}} = \\
 & \frac{2,774,137 - 123,750}{2,650,000} = 100.01 \text{ per cent.}
 \end{aligned}$$

This represents the net earnings on equity capital invested in the company and it will be noticed that 27 per cent. was distributed, the balance (73 per cent.) being retained in the business.

$$(b) \frac{\text{Net Profit minus Preference Dividend}}{\text{Ordinary Shareholders' interest in Company}} =$$

$$\frac{2,774,137 - 123,750}{15,402,807} = 17.21 \text{ per cent.}$$

The net earnings on the total equity capital employed in the business, i.e. subscribed capital plus accumulated reserves (capital and revenue) are revealed by this figure.

Ratio (b) gives the true net earnings on capital employed, the difference between (a) and (b) being due to the high reserves ratio (shown in calculation (m)).

$$(c) \frac{\text{Net Profit}}{\text{Net Assets}} = \frac{2,774,137}{18,402,807} = 15.07 \text{ per cent.}$$

This ratio shows the net profit earned on the assets employed in the business after deducting current liabilities.

In the foregoing calculations it will be noticed that net profit has been taken after charging taxation and after appropriations have been made to certain specific reserves.

$$(d) \frac{\text{Current Assets}}{\text{Current Liabilities and Provisions}} = \frac{24,702,906}{16,615,570} = 148.67 \text{ per cent. or } \pounds 1 \text{ 9s. 9d. to } \pounds 1.$$

Usually referred to as the *working capital ratio*, this indicates the resources available to meet the claims of creditors, but a more effective test of liquidity (which produces a vastly different result in this particular example) is obtained by excluding stock from the calculation, thus:—

$$(e) \frac{\text{Debtors plus Cash}}{\text{Current Liabilities and Provisions}} =$$

$$\frac{4,806,132 + 3,496,099}{16,615,570} = 49.97 \text{ per cent. or } 10\text{s. to } \pounds 1.$$

While it is true to say that at the date of the balance sheet only 10s. in liquid form is available to meet each $\pounds 1$ of debts owing, it will be appreciated that the creditors have not far to look elsewhere in the balance sheet for resources which could

be available to meet their debts with an appreciable margin to spare. The liquid ratio is, however, weak in this particular case, mainly due to the abnormal amount of capital sunk in stock. This important feature of the accounts was referred to on page 275.

$$(f) \quad \frac{\text{Investments plus Net Current Assets}}{\text{Fixed Assets}} = \frac{1,136,481 + 8,087,336}{9,178,990} = 100.49 \text{ per cent.}$$

This shows the relationship of net current assets to fixed assets. Investments have been included with current assets as the former obviously represent the investment of surplus cash.

It is important that the ratio of current assets to fixed assets should be adequate to meet the day-to-day requirements of the business. A low and decreasing percentage should be regarded as a danger signal and, if it is not practicable to dispense with some fixed assets, the introduction of additional capital would appear to be necessary. As a general rule, a higher ratio may be looked for in a trading business than in the case of a manufacturing company.

$$(g) \quad \frac{\text{Net Worth}}{\text{Total Liabilities and Provisions}} = \frac{18,402,807}{16,615,570} = 110.76 \text{ per cent.}$$

Sometimes termed the *proprietary ratio*, this formula can be reversed to produce the *creditors' ratio* and indicates the extent to which reliance is placed upon temporary financial resources.

$$(h) \quad \frac{\text{Net Worth}}{\text{Fixed Assets}} = \frac{18,402,807}{9,178,990} = 200.49 \text{ per cent.}$$

This ratio can be used for similar purposes as (f).

$$(i) \quad \frac{\text{Preference Capital plus Debentures}}{\text{Equity Capital}} = \frac{3,000,000 + \text{Nil}}{2,650,000} = 1.13 \text{ to } 1.$$

The *capital gearing* is an important factor in the finances of a company and is referred to in connection with a number of matters in this book.

Ratios (j) and (k) indicate average credit periods:—

$$(j) \quad \frac{\text{Sales}}{\text{Debtors}} = \frac{60,980,000}{4,806,132} = 12\frac{3}{4} \text{ times (per annum).}$$

The sales figure is taken from the statement on page 357. The *average* debtor balances outstanding would, of course, be a better figure to use, because seasonal conditions in a business may easily affect the volume of debtors at the balance sheet date. If £5 million can be regarded as the average debtors figure, it will be seen that the approximate average credit period allowed to customers is one month.

$$(k) \quad \frac{\text{Purchases}}{\text{Creditors}} = \frac{38,218,000}{9,423,116} = 4 \text{ times (per annum).}$$

The average figure would again be a more reliable basis for creditors (and no doubt some provisions should be included also), but the result on this basis indicates that the average credit period taken advantage of in the purchase of raw materials, etc., is three months.

$$(l) \quad \frac{\text{Purchases}}{\text{Stock}} = \frac{38,218,000}{16,400,675} = 2\frac{1}{2} \text{ times.}$$

This indicates that on average the stock is turned over only once in every five months.

The average stock figure in this example was probably less than the closing stock, but the ratio is exceptionally high, due to increasing prices of materials during the period and probably also to extensive forward buying to ensure adequate supplies of raw materials.

$$(m) \quad \frac{\text{Reserves (Capital and Revenue)}}{\text{Equity Capital}} = \frac{12,752,807}{2,650,000} = 481.24 \text{ per cent.}$$

This shows the *excess* of equity capital *employed* in the business over equity capital subscribed. In other words, for every £1 of ordinary capital subscribed, capital resources to the extent of £5 16s. od. are employed by the company.

It must be realised that where the total figure of fixed assets has been employed in the foregoing calculations it is the book values which have been used. Real values are, of course, very considerably in excess of book values at the present

time. (Attention was given to the important and controversial subject of inflation in Chapter XV.)

The foregoing brief introduction to the study of accounting ratios (necessarily confined in this chapter to the figures contained in published accounts) may stimulate the reader to make a more extensive examination of this absorbing subject from some of the more specialised books now available. It will be appreciated that the value of computing ratios on these lines lies more particularly in comparing the calculations relative to two or more consecutive years or two or more businesses.

SPECIAL POINTS FOR ATTENTION WHEN EXAMINING PUBLISHED ACCOUNTS.

The conclusions reached when analysing a balance sheet relate to the position as it is shown at the date of the statement. A danger exists that these inferences may be regarded too rigorously by the observer, owing to a lack of appreciation of the constantly changing character of most businesses. The balance sheet affords an opportunity for an annual appraisalment of a company's financial position, but that position may materially change within a short period after the balance sheet date.

It therefore behoves those who are interested in the fortunes of a company to keep watch on such pointers as are available in the interim between the publication of one balance sheet and the next. Useful indications are the market price of the company's shares and debentures, such information as is afforded by the directors' reports, the chairman's speeches at annual meetings, trade announcements indicating new business, and information relating to the company's activities which may be reported in the press.

In addition to the matters which have been exemplified on the foregoing pages, a number of other useful tests may be applied in the analysis of a balance sheet.

When assessing the value of assets, fictitious assets such as preliminary expenses, discount on shares and debentures, cost of issuing shares and debentures, etc. should be entirely discounted. These items represent expenditure carried forward for writing off to revenue in future years, and are entirely valueless. This assertion does not apply to all items of deferred expenditure; advertising, rates, insurance, etc., carried forward usually represent real value at the balance

sheet date which will accrue to the company in the near future. Development expenditure may, however, have a value which is largely dependent on the success of future operations.

In Balance Sheet No. 1 on page 270, the capital comprises £1 Ordinary Shares, 16s. per share paid-up, the uncalled capital being equivalent to 25 per cent. of the paid-up capital. Uncalled capital constitutes a safeguard to creditors; the amount uncalled being regarded by them as a capital reserve. When uncalled capital is appreciable in relation to issued capital, a large creditor might be advised to obtain a list of the names, addresses and descriptions of members in order to ascertain, as far as possible, the financial standing of the principal shareholders.

The rate of interest payable on debentures, and the price at which they are issued are fairly reliable indications of a company's financial standing. It may be taken for granted that a company will not issue debentures upon terms which are any more favourable to debenture holders than is necessary to ensure the loan being taken up. The more favourable to debenture holders the conditions of issue appear to be, the less financial prestige the company may be regarded as possessing.

When temporary loans, including bank overdrafts, appear in the balance sheet, it may be worth noticing whether such accommodation appears to have been obtained for extensions or for normal business requirements. Temporary loans for extensions, until such time as they can be financed out of profits, are often preferable to issuing shares or debentures. If, however, the loans are required for current trading purposes, this may indicate that the company's credit does not permit of the more economical procedure of obtaining the requisite finance by a more permanent expedient. It may be, of course, that the accommodation is of short duration to meet seasonal demands, and in these circumstances no objection can be taken to the course adopted. The alternative might involve maintaining for a greater part of the year, bank balances (upon which little or no interest is earned) in excess of the company's needs.

Assets of a specialised character acquired for the particular purposes of a business should be liberally discounted when assessing the worth of a company's possessions, as they will have a comparatively low break-up value. An exception to this

rule is when the company under review is carrying on business with sustained prosperity and there is accordingly every assurance that the value appended to the specialised assets will accrue in full to the company in course of use as distinct from disposal.

It is always advisable to ascertain the ratio of net current assets to fixed assets (see page 280). When there is a gradual shifting of the proportion of fixed assets to current assets over a period of years, this may indicate a general change of policy, or reflect the entry of new competition.

The danger of directors recommending dividends on equity capital on a too generous scale has been referred to in the chapter on profits. Attention was also given in that chapter to the commendable practice adopted by some companies of financing extensions out of profits, and when a balance sheet shows (by the presence of substantial reserves invested within the business) that this procedure has been followed, the critic is usually justified in feeling assured that affairs are being prudently conducted.

Finally, the possibility of secret reserves existing must be kept in mind, as hidden resources are not entirely ruled out by the Act, despite the fuller disclosure of provisions and reserves which is required. For example, the obvious understatement or omission of goodwill should be carefully noticed and it will be realised that fixed assets are nowadays normally shown below current values. The conclusions drawn from the figures appearing in the balance sheet must not, however, be unduly influenced by optimistic assumptions that any hidden resources exist particularly in view of the more exacting statutory requirements since 1948.

VARIOUS VIEWPOINTS.

A criticism—whatever the subject—is often materially tempered by the critic's own particular outlook and personal interests. The examination of a balance sheet is no exception to this precept, and we find that persons analyse balance sheets from the viewpoint of their own especial relationship, or prospective relationship, to the company. We will, therefore, briefly consider the viewpoints peculiar to (a) the prospective creditor; (b) the banker; (c) the prospective investor (shareholder or debenture holder) and (d) the executive.

(a) THE PROSPECTIVE CREDITOR.

The trader, contractor or financier who has been invited to supply a company with goods or services on credit will look primarily to the liquid assets and current liabilities of the business. He wants the balance sheet to give him a clear indication that the business possesses the ability at the date of the document, to meet the obligations then outstanding. If the cash balances, trade debts, bills receivable and marketable investments exceed the trade and sundry liabilities and temporary loans, including any bank overdraft, with a reasonable margin for contingencies, he may feel justified in allowing the credit required.

In the event of assets having been liberally charged to secure loans or overdrafts, the prospective creditor may deem it advisable to require that some security be given to cover a portion, or the whole, of the credit it is proposed to allow.

(b) THE BANKER.

The banker will probably have been approached for a loan, to be effected either by a lump sum transfer of cash or, as is more usual, by giving his customer the temporary right to overdraw his balance up to a specified limit. He will therefore peruse the customer's accounts with the object of ascertaining to what extent the business is carrying on a normal healthy trade, calculated to attract a fair return in the way of profit without appreciable fluctuations. As we have already observed, the profit and loss account will usually be of little assistance in showing the volume of trade, and the banker would require to see a copy of the full trading and profit and loss account to obtain this information, but scrutiny of a few balance sheets for successive years will indicate whether a remunerative rate of income is being earned on the capital employed. This test will show whether his customer's business is capable of standing upon its own feet financially.

If it appears that this is not the case, the advisable course for the banker to adopt is to obtain, if possible, a mortgage on specific assets in preference to granting a loan on the meagre security of his own confidence in the ability of the business to meet its obligations in the future.

The banker will also endeavour to ascertain what has caused a depletion in the company's cash resources necessitating the request for financial aid. By the simple rules of debit and

credit, a reduction of the figure standing against any particular asset, when compared with the amount appearing in a previous balance sheet, involves a corresponding increase in other assets, or a reduction on the liabilities side, or a combination of both changes.

He may discover that the reduced cash balance is compensated by:—

- | | |
|---|--|
| (a) an increase in fixed assets | caused by additions to buildings, machinery, etc. or introduction of more modern plant. |
| (b) an increase in stock carried | caused by increase in turnover, advantageous advance purchases, over-trading, or sudden slump. |
| (c) an increase in debtors | caused by increase in turnover, extension of credit allowed, removal of discount facilities, or incompetent control. |
| (d) an increase in investments | caused by acquisition of subsidiary companies, speculations, financing of related businesses. |
| (e) a reduction in liabilities | caused by greater promptitude in settlement of trade debts for discount or other reasons, redemption of debentures or loans. |
| (f) a reduction in capital | caused by redemption of preference shares, or effected with consent of Court. |
| (g) a reduction in reserves or balance of profit and loss account | caused by trading losses, payment of dividends in excess of current profits earned, etc. |

As stated in Chapter II the accounts will show the effect rather than the cause of the changes, and further enquiry will usually be necessary to elicit the required information. Again, in many cases, the view of the effect may be obliterated by other changes in the business, and the difficulty will be more pronounced when the cash reduction is not appreciable. But the fact that some indication of the cause of the shortage of liquid resources may be obtained from the balance sheet, renders that statement of inestimable value to the banker in deciding whether he is justified, from his own standpoint, in temporarily repairing the cash position.

The banker will require to know the specific purpose or purposes for which the loan or overdraft is required so that he can estimate the effect of such policy on future balance sheets. Banks have, in recent years, been required to have

regard to the Government's capital policies when affording financial accommodation to customers.

In assessing the worth of assets comprised in the balance sheet, all intangible and fictitious values, such as goodwill, preliminary expenses, discount on debentures, etc. will be entirely ignored by the banker.

(c) THE PROSPECTIVE INVESTOR.

The angle of investigation adopted by a prospective investor depends upon whether he proposes to purchase debentures, preference shares, or shares carrying deferred dividend rights. If he is an embryo debenture holder he will pay particular attention to the assets which the company proposes to mortgage as security, or the assets included in any floating charge to be created. The ratio of the aggregate sum required to pay the interest on debentures to the average profits of previous years is also, to him, a matter of vital importance. This calculation shows how many times the debenture interest is covered by average profits.

If the investor is considering the purchase of preference shares, he will apply a similar test to that advocated for the debenture holder in regard to profits cover. In making this calculation, the amount required to pay debenture interest must be deducted from average profits. The ratio of preference capital to ordinary capital is also an important consideration when assessing the extent to which the preference shares are covered by capital assets.

The prospective ordinary or deferred shareholder will be mainly concerned with the profit available after payment of dividend on the prior capital when expressed as a percentage of the ordinary capital. Incidental points to be noted by him are whether such profit is reasonably constant, or subject to appreciable fluctuations, and whether the rate is increasing from year to year, or the reverse. When profits have been on a rising scale there would appear to be reasonable expectations of enhanced profits in the future. If dividends have been restrained by the operation of "dividend limitation" (discussed in Chapter XV)—a fact which will be apparent from the disparity between profits *earned* and profits *distributed* in post-war years—this also will indicate that capital or revenue distributions on a satisfactory scale may be anticipated at some time in the future.

The higher the ratio of preference capital to ordinary capital, the greater the burden of profits tax will be, since the rate chargeable on distributed profits (now 50 per cent.) is calculated on preference as well as ordinary dividends but is borne entirely by the ordinary shareholders.

It is almost impossible to lay down any definite rule as to what constitutes a satisfactory return on that capital to which equity dividend rights attach. Super-profits have already been defined. The breadth of margin which the investor will consider adequate to compensate him for the extra risk involved, depends upon the nature of the company's business and its record of past profits. And it may be that compulsory dividend limitation will not at present permit this margin to be achieved.

Reserves are a matter of interest to shareholders. While such resources really belong to the ordinary or deferred shareholders, and increase the intrinsic value of their capital, they also constitute a margin of income safety to preference shareholders, particularly when the preference dividend is non-cumulative.

The investor, therefore, can obtain the following useful information from the published accounts, when they are looked at in conjunction with the accounts of previous years:—

- (1) Rates of profit earned in recent years.
- (2) Amount of undrawn profits, and perhaps some impression of the financial policy of the company in the past showing it to have been conservative or otherwise.
- (3) An approximate valuation of the capital when measured in terms of asset values.
- (4) General nature of the assets.
- (5) Extent and nature of the liabilities (e.g. whether secured on assets or not).
- (6) Aggregate amount of reserves, and whether the reserves are increasing or diminishing.
- (7) Annual turnover, if this figure is shown in the profit and loss account or is available from any statement of turnover analysis.

With due appreciation of the limitations of a balance sheet, he should also safeguard himself by ascertaining:—

- (1) Market quotations, if any, of the capital and debentures.

- (2) Extent to which the business is established, and the nature of any existing or prospective competition.
- (3) The personnel of the executives.

In regard to (1), the market quotation of debentures usually furnishes a more reliable criterion of investment values than that of shares, being less sensitive to extraneous elements, and less subject to manipulation by speculators.

(d) THE EXECUTIVE.

The responsibility for the accuracy and publication of the accounts lies with the directors.* The accounts must be signed on behalf of the board by two directors, or if there is only one director, by that director (section 155). The directors' outlook is not one of criticism, as in the previous viewpoints discussed; they must be prepared to defend the contents and answer any questions which may be asked by shareholders. The statements under review are their accounts to the shareholders and show the results of their stewardship for the past year.

Directors should therefore effect a very careful comparison of the current figures with the corresponding amounts in the accounts. The reasons for all variations should be thoroughly sifted, so that any defects in the organisation or errors of policy may be exposed and corrected.

The financial position as displayed by each annual balance sheet constitutes a definite milestone in a company's career. The information contained in it frequently gives cause for self-congratulation and satisfaction, or conversely, for recriminations in regard to past policies or management. It also serves as a useful image of the present position from which future progress may often be anticipated with a reasonable degree of accuracy.

* The provisos contained in sections 147, 148 and 149 are referred to on page 205.

APPENDIX A

STATUTORY REQUIREMENTS

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THE TEXT OF THE COMPANIES ACT, 1948, RELATING TO ACCOUNTS AND OTHER MATTERS DEALT WITH IN THIS BOOK.

Issued copies of memorandum to embody alterations.

25.—(1) Where an alteration is made in the memorandum of a company, every copy of the memorandum issued after the date of the alteration shall be in accordance with the alteration.

(2) If, where any such alteration has been made, the company at any time after the date of the alteration issues any copies of the memorandum which are not in accordance with the alteration, it shall be liable to a fine not exceeding one pound for each copy so issued, and every officer of the company who is in default shall be liable to the like penalty.

Membership of holding company.

27.—(1) Except in the cases hereafter in this section mentioned, a body corporate cannot be a member of a company which is its holding company, and any allotment or transfer of shares in a company to its subsidiary shall be void.

(2) Nothing in this section shall apply where the subsidiary is concerned as personal representative, or where it is concerned as trustee, unless the holding company or a subsidiary thereof is beneficially interested under the trust and is not so interested only by way of security for the purposes of a transaction entered into by it in the ordinary course of a business which includes the lending of money.

(3) This section shall not prevent a subsidiary which is, at the commencement of this Act, a member of its holding company, from continuing to be a member but, subject to the last foregoing subsection, the subsidiary shall have no right to vote at meetings of the holding company or any class of members thereof.

(4) Subject to subsection (2) of this section, subsections (1) and (3) thereof shall apply in relation to a nominee for a body corporate which is a subsidiary, as if references in the said subsections (1) and (3) to such a body corporate included references to a nominee for it.

(5) In relation to a company limited by guarantee or unlimited which is a holding company, the reference in this section to shares, whether or not it has a share capital, shall be construed as including a reference to the interest of its members as such, whatever the form of that interest.

Meaning of "private company."

28.—(1) For the purposes of this Act, the expression "private company" means a company which by its articles—

(a) restricts the right to transfer its shares; and

(b) limits the number of its members to fifty, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have continued after the

determination of that employment to be, members of the company; and

- (c) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

(2) Where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this section, be treated as a single member.

54.—(1) Subject as provided in this section, it shall not be lawful for a company to give, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, any financial assistance for the purpose of or in connection with a purchase or subscription made or to be made by any person or for any shares in the company, or, where the company is a subsidiary company, in its holding company:

Prohibition of provision of financial assistance by company for purchase of or subscription for its own, or its holding company's shares.

Provided that nothing in this section shall be taken to prohibit—

- (a) where the lending of money is part of the ordinary business of a company, the lending of money by the company in the ordinary course of its business;
- (b) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for, fully-paid shares in the company or its holding company, being a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company, including any director holding a salaried employment or office in the company;
- (c) the making by a company of loans to persons, other than directors, bona fide in the employment of the company with a view to enabling those persons to purchase or subscribe for fully-paid shares in the company or its holding company to be held by themselves by way of beneficial ownership.

(2) If a company acts in contravention of this section, the company and every officer of the company who is in default shall be liable to a fine not exceeding one hundred pounds.

Issue of Shares at Premium and Discount and Redeemable Preference Shares.

56.—(1) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called "the share premium account," and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the share premium account were paid up share capital of the company.

Application of premiums received on issue of shares.

(2) The share premium account may, notwithstanding anything in the foregoing subsection, be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares, in writing off—

- (a) the preliminary expenses of the company; or
- (b) the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;

or in providing for the premium payable on redemption of any redeemable preference shares or of any debentures of the company.

(3) Where a company has before the commencement of this Act issued any shares at a premium, this section shall apply as if the shares had been issued after the commencement of this Act:

Provided that any part of the premiums which has been so applied that it does not at the commencement of this Act form an identifiable part of the company's reserves within the meaning of the Eighth Schedule to this Act shall be disregarded in determining the sum to be included in the share premium account.

Power to
issue shares at
a discount.

57.—(1) Subject as provided in this section, it shall be lawful for a company to issue at a discount shares in the company of a class already issued:

Provided that—

- (a) the issue of the shares at a discount must be authorised by resolution passed in general meeting of the company, and must be sanctioned by the court;
- (b) the resolution must specify the maximum rate of discount at which the shares are to be issued;
- (c) not less than one year must at the date of the issue have elapsed since the date on which the company was entitled to commence business;
- (d) the shares to be issued at a discount must be issued within one month after the date on which the issue is sanctioned by the court or within such extended time as the court may allow.

(2) Where a company has passed a resolution authorising the issue of shares at a discount, it may apply to the court for an order sanctioning the issue, and on any such application the court, if, having regard to all the circumstances of the case, it thinks proper so to do, may make an order sanctioning the issue on such terms and conditions as it thinks fit.

(3) Every prospectus relating to the issue of the shares must contain particulars of the discount allowed on the issue of the shares or of so much of that discount as has not been written off at the date of the issue of the prospectus.

If default is made in complying with this subsection, the company and every officer of the company who is in default shall be liable to a default fine.

Power to issue
redeemable
preference
shares.

58.—(1) Subject to the provisions of this section, a company limited by shares may, if so authorised by its articles, issue preference shares which are, or at the option of the company are to be liable, to be redeemed:

Provided that—

- (a) no such shares shall be redeemed except out of profits of the company which would otherwise be available for dividend or out of the proceeds of a fresh issue of shares made for the purposes of the redemption;
- (b) no such shares shall be redeemed unless they are fully paid;
- (c) the premium, if any, payable on redemption, must have been provided for out of the profits of the company or out of the company's share premium account before the shares are redeemed;

(d) where any such shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall out of profits which would otherwise have been available for dividend be transferred to a reserve fund, to be called "the capital redemption reserve fund," a sum equal to the nominal amount of the shares redeemed, and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve fund were paid-up share capital of the company.

(2) Subject to the provisions of this section, the redemption of preference shares thereunder may be effected on such terms and in such manner as may be provided by the articles of the company.

(3) The redemption of preference shares under this section by a company shall not be taken as reducing the amount of the company's authorised share capital.

(4) Where in pursuance of this section a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued, and accordingly the share capital of the company shall not for the purposes of any enactments relating to stamp duty be deemed to be increased by the issue of shares in pursuance of this subsection:

Provided that, where new shares are issued before the redemption of the old shares, the new shares shall not, so far as relates to stamp duty, be deemed to have been issued in pursuance of this subsection unless the old shares are redeemed within one month after the issue of the new shares.

(5) The capital redemption reserve fund may, notwithstanding anything in this section, be applied by the company in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Miscellaneous Provisions as to Share Capital.

59.—A company, if so authorised by its articles, may do any one or more of the following things—

- (a) make arrangements on the issue of shares for a difference between the shareholders in the amounts and times of payment of calls on their shares;
- (b) accept from any member the whole or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up;
- (c) pay dividend in proportion to the amount paid up on each share where a larger amount is paid up on some shares than on others.

Power of company to arrange for different amounts being paid on shares.

60.—A limited company may by special resolution determine that any portion of its share capital which has not been already called up shall not be capable of being called up except in the event and for the purposes of the company being wound up, and thereupon that portion of its share capital shall not be capable of being called up except in the event and for the purposes aforesaid.

Reserve liability of limited company.

Power of company limited by shares to alter its share capital.

61.—(1) A company limited by shares or a company limited by guarantee and having a share capital, if so authorised by its articles, may alter the conditions of its memorandum as follows, that is to say, it may—

- (a) increase its share capital by new shares of such amount as it thinks expedient;
- (b) consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
- (c) convert all or any of its paid-up shares into stock, and reconvert that stock into paid-up shares of any denomination;
- (d) subdivide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the subdivision the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case of the share from which the reduced share is derived;
- (e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

(2) The powers conferred by this section must be exercised by the company in general meeting.

(3) A cancellation of shares in pursuance of this section shall not be deemed to be a reduction of share capital within the meaning of this Act.

Notice to registrar of consolidation of share capital, conversion of shares into stock, &c.

62.—(1) If a company having a share capital has—

- (a) consolidated and divided its share capital into shares of larger amount than its existing shares; or
- (b) converted any shares into stock; or
- (c) re-converted stock into shares; or
- (d) subdivided its shares or any of them; or
- (e) redeemed any redeemable preference shares; or
- (f) cancelled any shares, otherwise than in connection with a reduction of share capital under section sixty-six of this Act;

it shall within one month after so doing give notice thereof to the registrar of companies specifying, as the case may be, the shares consolidated, divided, converted, sub-divided, redeemed or cancelled, or the stock re-converted.

(2) If default is made in complying with this section, the company and every officer of the company who is in default shall be liable to a default fine.

Notice of increase of share capital.

63.—(1) Where a company having a share capital, whether its shares have or have not been converted into stock, has increased its share capital beyond the registered capital, it shall, within fifteen days after the passing of the resolution authorising the increase, give to the registrar of companies notice of the increase, and the registrar shall record the increase.

(2) The notice to be given as aforesaid shall include such particulars as may be prescribed with respect to the classes of shares affected and the conditions subject to which the new shares have been or are

to be issued, and there shall be forwarded to the registrar of companies together with the notice a printed copy of the resolution authorising the increase.

(3) If default is made in complying with this section, the company and every officer of the company who is in default shall be liable to a default fine.

64.—An unlimited company having a share capital may, by its resolution for registration as a limited company in pursuance of this Act, do either or both of the following things, namely:—

Power of unlimited company to provide for reserve share capital on re-registration.

- (a) increase the nominal amount of its share capital by increasing the nominal amount of each of its shares, but subject to the condition that no part of the increased capital shall be capable of being called up except in the event and for the purposes of the company being wound up;
- (b) provide that a specified portion of its uncalled share capital shall not be capable of being called up except in the event and for the purposes of the company being wound up.

65.—(1) Where any shares of a company are issued for the purpose of raising money to defray the expenses of the construction of any works or buildings or the provision of any plant which cannot be made profitable for a lengthened period, the company may pay interest on so much of that share capital as is for the time being paid up for the period and subject to the conditions and restrictions in this section mentioned, and may charge the sum so paid by way of interest to capital as part of the cost of construction of the work or building, or the provision of plant:

Power of company to pay interest out of capital in certain cases.

Provided that—

- (a) no such payment shall be made unless it is authorised by the articles or by special resolution;
- (b) no such payment, whether authorised by the articles or by special resolution, shall be made without the previous sanction of the Board of Trade;
- (c) before sanctioning any such payment the Board of Trade may, at the expense of the company, appoint a person to inquire and report to them as to the circumstances of the case, and may, before making the appointment, require the company to give security for the payment of the costs of the inquiry;
- (d) the payment shall be made only for such period as may be determined by the Board of Trade, and that period shall in no case extend beyond the close of the half year next after the half year during which the works or buildings have been actually completed or the plant provided;
- (e) the rate of interest shall in no case exceed four per cent. per annum or such other rate as may for the time being be prescribed by the order of the Treasury;
- (f) the payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid;
- (g) nothing in this section shall affect any company to which the Indian Railways Act, 1894, as amended by any subsequent enactment, applies.

57 & 58 Vict. c. 13.

(2) The power conferred by this section on the Treasury shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

Reduction of Share Capital.

Special resolution for reduction of share capital.

66.—(1) Subject to confirmation by the court, a company limited by shares or a company limited by guarantee and having a share capital may, if so authorised by its articles, by special resolution reduce its share capital in any way, and in particular, without prejudice to the generality of the foregoing power, may—

- (a) extinguish or reduce the liability on any of its shares in respect of share capital not paid up; or
- (b) either with or without extinguishing or reducing liability on any of its shares, cancel any paid-up share capital which is lost or unrepresented by available assets; or
- (c) either with or without extinguishing or reducing liability on any of its shares, pay off any paid-up share capital which is in excess of the wants of the company;

and may, if and so far as is necessary, alter its memorandum by reducing the amount of its share capital and of its shares accordingly.

(2) A special resolution under this section is in this Act referred to as “a resolution for reducing share capital.”

Application to court for confirming order, objections by creditors, and settlement of list of objecting creditors.

67.—(1) Where a company has passed a resolution for reducing share capital, it may apply to the court for an order confirming the reduction.

(2) Where the proposed reduction of share capital involves either diminution of liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital, and in any other case if the court so directs, the following provisions shall have effect, subject nevertheless to the next following subsection:—

- (a) every creditor of the company who at the date fixed by the court is entitled to any debt or claim which, if that date were the commencement of the winding up of the company, would be admissible in proof against the company, shall be entitled to object to the reduction;
- (b) the court shall settle a list of creditors so entitled to object, and for that purpose shall ascertain, as far as possible without requiring an application from any creditor, the names of those creditors and the nature and amount of their debts or claims, and may publish notices fixing a day or days within which creditors not entered on the list are to claim to be so entered or are to be excluded from the right of objecting to the reduction;
- (c) where a creditor entered on the list whose debt or claim is not discharged or has not determined does not consent to the reduction, the court may, if it thinks fit, dispense with the consent of that creditor, on the company securing payment of his debt or claim by appropriating, as the court may direct, the following amount:—

(i) if the company admits the full amount of the debt or claim, or, though not admitting it, is willing to provide for it, then the full amount of the debt or claim;

(ii) if the company does not admit, and is not willing to provide for the full amount of the debt or claim, or if the amount is contingent or not ascertained, then an amount fixed by the court after the like inquiry and adjudication as if the company were being wound up by the court.

(3) Where a proposed reduction of share capital involves either the diminution of any liability in respect of unpaid share capital or the payment to any shareholder of any paid-up share capital, the court may, if, having regard to any special circumstances of the case, it thinks proper so to do, direct that subsection (2) of this section shall not apply as regards any class or any classes of creditors.

68.—(1) The court, if satisfied, with respect to every creditor of the company who under the last foregoing section is entitled to object to the reduction, that either his consent to the reduction has been obtained or his debt or claim has been discharged or has determined, or has been secured, may make an order confirming the reduction on such terms and conditions as it thinks fit.

Order confirming reduction and powers of court on making such order.

(2) Where the court makes any such order, it may—

- (a) if for any special reason it thinks proper so to do, make an order directing that the company shall, during such period, commencing on or at any time after the date of the order, as is specified in the order, add to its name as the last words thereof the words "and reduced"; and
- (b) make an order requiring the company to publish as the court directs the reasons for reduction or such other information in regard thereto as the court may think expedient with a view to giving proper information to the public, and, if the court thinks fit, the causes which led to the reduction.

(3) Where a company is ordered to add to its name the words "and reduced," those words shall, until the expiration of the period specified in the order, be deemed to be part of the name of the company.

69.—(1) The registrar of companies, on production to him of an order of the court confirming the reduction of the share capital of a company, and the delivery to him of a copy of the order and of a minute approved by the court showing, with respect to the share capital of the company as altered by the order, the amount of the share capital, the number of shares into which it is to be divided, and the amount of each share, and the amount, if any, at the date of the registration deemed to be paid up on each share, shall register the order and minute.

Registration of order and minute of reduction.

(2) On the registration of the order and minute, and not before, the resolution for reducing share capital as confirmed by the order so registered shall take effect.

(3) Notice of the registration shall be published in such manner as the court may direct.

(4) The registrar shall certify under his hand the registration of the order and minute, and his certificate shall be conclusive evidence that all the requirements of this Act with respect to reduction of share capital have been complied with, and that the share capital of the company is such as is stated in the minute.

(5) The minute when registered shall be deemed to be substituted for the corresponding part of the memorandum, and shall be valid and alterable as if it had been originally contained therein.

(6) The substitution of any such minute as aforesaid for part of the memorandum of the company shall be deemed to be an alteration of the memorandum within the meaning of section twenty-five of this Act.

Liability of
members in
respect of re-
duced shares.

70.—(1) In the case of a reduction of share capital, a member of the company, past or present, shall not be liable in respect of any share to any call or contribution exceeding in amount the difference, if any, between the amount of the share as fixed by the minute and the amount paid, or the reduced amount, if any, which is to be deemed to have been paid, on the share, as the case may be:

Provided that, if any creditor, entitled in respect of any debt or claim to object to the reduction of share capital, is, by reason of his ignorance of the proceedings for reduction, or of their nature and effect with respect to his claim, not entered on the list of creditors, and, after the reduction, the company is unable, within the meaning of the provisions of this Act with respect to winding up by the court, to pay the amount of his debt or claim, then—

(a) every person who was a member of the company at the date of the registration of the order for reduction and minute, shall be liable to contribute for the payment of that debt or claim an amount not exceeding the amount which he would have been liable to contribute if the company had commenced to be wound up on the day before the said date; and

(b) if the company is wound up, the court, on the application of any such creditor and proof of his ignorance as aforesaid, may, if it thinks fit, settle accordingly a list of persons so liable to contribute, and make and enforce calls and orders on the contributories settled on the list, as if they were ordinary contributories in a winding up.

(2) Nothing in this section shall affect the rights of the contributories among themselves.

Penalty for con-
cealing of name
of creditor, &c.

71.—If any officer of the company—

(a) wilfully conceals the name of any creditor entitled to object to the reduction; or

(b) wilfully misrepresents the nature or amount of the debt or claim of any creditor; or

(c) aids, abets or is privy to any such concealment or misrepresentation as aforesaid,

he shall be guilty of a misdemeanour.

Variation of Shareholders' Rights.

Rights of
holders of
special classes
of shares.

72.—(1) If, in the case of a company the share capital of which is divided into different classes of shares, provision is made by the memorandum or articles for authorising the variation of the rights attached to any class of shares in the company, subject to the consent of any specified proportion of the holders of the issued shares of that class or the sanction of a resolution passed at a separate meeting of the holders of those shares, and in pursuance of the said provision the

rights attached to any such class of shares are at any time varied, the holders of not less in the aggregate than fifteen per cent. of the issued shares of that class, being persons who did not consent to or vote in favour of the resolution for the variation, may apply to the court to have the variation cancelled, and, where any such application is made, the variation shall not have effect unless and until it is confirmed by the court.

(2) An application under this section must be made within twenty-one days after the date on which the consent was given or the resolution was passed, as the case may be, and may be made on behalf of the shareholders entitled to make the application by such one or more of their number as they may appoint in writing for the purpose.

(3) On any such application the court, after hearing the applicant and any other persons who apply to the court to be heard and appear to the court to be interested in the application, may, if it is satisfied, having regard to all the circumstances of the case, that the variation would unfairly prejudice the shareholders of the class represented by the applicant, disallow the variation and shall, if not so satisfied, confirm the variation.

(4) The decision of the court on any such application shall be final.

(5) The company shall within fifteen days after the making of an order by the court on any such application forward a copy of the order to the registrar of companies, and, if default is made in complying with this provision, the company and every officer of the company who is in default shall be liable to a default fine.

(6) The expression "variation" in this section includes abrogation and the expression "varied" shall be construed accordingly.

Transfer of Shares and Debentures, Evidence of Titles &c.

73.—The shares or other interest of any member in a company shall be personal estate, transferable in manner provided by the articles of the company, and shall not be of the nature of real estate. Nature of shares.

74.—Each share in a company having a share capital shall be distinguished by its appropriate number: Numbering of shares.

Provided that, if at any time all the issued shares in a company, or all the issued shares therein of a particular class, are fully paid up and rank *pari passu* for all purposes, none of those shares need thereafter have a distinguishing number so long as it remains fully paid up and ranks *pari passu* for all purposes with all shares of the same class for the time being issued and fully paid up.

87.—(1) Every register of holders of debentures of a company shall, except when duly closed (but subject to such reasonable restrictions as the company may in general meeting impose, so that not less than two hours in each day shall be allowed for inspection), be open to the inspection of the registered holder of any such debentures or any holder of shares in the company without fee, and of any other person on payment of a fee of one shilling or such less sum as may be prescribed by the company. Rights of inspection of register of debenture holders and to copies of register and trust deed.

(2) Any such registered holder of debentures or holder of shares as aforesaid or any other person may require a copy of the register of the holders of debentures of the company or any part thereof on payment of sixpence for every hundred words required to be copied.

(3) A copy of any trust deed for securing any issue of debentures shall be forwarded to every holder of any such debentures at his request on payment in the case of a printed trust deed of the sum of one shilling or such less sum as may be prescribed by the company, or, where the trust deed has not been printed, on payment of sixpence for every hundred words required to be copied.

(4) If inspection is refused, or a copy is refused or not forwarded, the company and every officer of the company who is in default shall be liable to a fine not exceeding five pounds, and further shall be liable to a default fine of two pounds.

(5) Where a company is in default as aforesaid, the court may by order compel an immediate inspection of the register or direct that the copies required shall be sent to the person requiring them.

(6) For the purposes of this section, a register shall be deemed to be duly closed if closed in accordance with provisions contained in the articles or in the debentures or, in the case of debenture stock, in the stock certificates, or in the trust deed or other document securing the debentures or debenture stock, during such period or periods, not exceeding in the whole thirty days in any year, as may be therein specified.

Liability of
trustees for
debenture
holders.

88.—(1) Subject to the following provisions of this section, any provision contained in a trust deed for securing an issue of debentures, or in any contract with the holders of debentures secured by a trust deed, shall be void in so far as it would have the effect of exempting a trustee thereof from or indemnifying him against liability for breach of trust where he fails to show the degree of care and diligence required of him as trustee, having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions.

(2) The foregoing subsection shall not invalidate—

(a) any release otherwise validly given in respect of anything done or omitted to be done by a trustee before the giving of the release; or

(b) any provision enabling such a release to be given—

(i) on the agreement thereto of a majority of not less than three-fourths in value of the debenture holders present and voting in person or, where proxies are permitted, by proxy at a meeting summoned for the purpose; and

(ii) either with respect to specific acts or omissions or on the trustee dying or ceasing to act.

(3) Subsection (1) of this section shall not operate—

(a) to invalidate any provision in force at the commencement of this Act so long as any person then entitled to the benefit of that provision or afterwards given the benefit thereof under the next following subsection remains a trustee of the deed in question; or

(b) to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force.

(4) While any trustee of a trust deed remains entitled to the benefit of a provision saved by the last foregoing subsection, the benefit of that provision may be given either—

- (a) to all trustees of the deed, present and future; or
- (b) to any named trustees or proposed trustees thereof;

by a resolution passed by a majority of not less than three-fourths in value of the debenture holders present in person or, where proxies are permitted, by proxy at a meeting summoned for the purpose in accordance with the provisions of the deed or, if the deed makes no provision for summoning meetings, a meeting summoned for the purpose in any manner approved by the court.

89.—A condition contained in any debentures or in any deed for securing any debentures, whether issued or executed before or after the commencement of this Act, shall not be invalid by reason only that the debentures are thereby made irredeemable or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long, any rule of equity to the contrary notwithstanding.

90.—(1) Where either before or after the commencement of this Act a company has redeemed any debentures previously issued, then—

- (a) unless any provision to the contrary, whether express or implied, is contained in the articles or in any contract entered into by the company; or
- (b) unless the company has, by passing a resolution to that effect or by some other act, manifested its intention that the debentures shall be cancelled;

the company shall have, and shall be deemed always to have had, power to re-issue the debentures, either by re-issuing the same debentures or by issuing other debentures in their place.

(2) Subject to the provisions of the next following section, on a re-issue of redeemed debentures the person entitled to the debentures shall have, and shall be deemed always to have had, the same priorities as if the debentures had never been redeemed.

(3) Where a company has either before or after the commencement of this Act deposited any of its debentures to secure advances from time to time on current account or otherwise, the debentures shall not be deemed to have been redeemed by reason only of the account of the company having ceased to be in debit whilst the debentures remained so deposited.

(4) The re-issue of a debenture or the issue of another debenture in its place under the power by this section given to, or deemed to have been possessed by, a company, whether the re-issue or issue was made before or after the commencement of this Act, shall be treated as the issue of a new debenture for the purposes of stamp duty, but it shall not be so treated for the purposes of any provision limiting the amount or number of debentures to be issued:

Provided that any person lending money on the security of a debenture re-issued under this section which appears to be duly stamped may give the debenture in evidence in any proceedings for enforcing his security without payment of the stamp duty or any penalty in respect thereof, unless he had notice or, but for his negligence, might have discovered, that the debenture was not duly stamped, but in any such case the company shall be liable to pay the proper stamp duty and penalty.

Perpetual
debentures.

Power to
re-issue
redeemed
debentures in
certain cases.

Specific performance of contracts to subscribe for debentures.

92.—A contract with a company to take up and pay for any debentures of the company may be enforced by an order for specific performance.

PART III.

REGISTRATION OF CHARGES.

Registration of Charges with Registrar of Companies.

Registration of charges created by companies registered in England.

95.—(1) Subject to the provisions of this Part of this Act, every charge created after the fixed day by a company registered in England and being a charge to which this section applies shall, so far as any security on the company's property or undertaking is conferred thereby, be void against the liquidator and any creditor of the company, unless the prescribed particulars of the charge together with the instrument, if any, by which the charge is created or evidenced, are delivered to or received by the registrar of companies for registration in manner required by this Act within twenty-one days after the date of its creation, but without prejudice to any contract or obligation for repayment of the money thereby secured, and when a charge becomes void under this section the money secured thereby shall immediately become payable.

(2) This section applies to the following charges:—

- (a) a charge for the purpose of securing any issue of debentures;
- (b) a charge on uncalled share capital of the company;
- (c) a charge created or evidenced by an instrument which, if executed by an individual, would require registration as a bill of sale;
- (d) a charge on land, wherever situate, or any interest therein, but not including a charge for any rent or other periodical sum issuing out of land;
- (e) a charge on book debts of the company;
- (f) a floating charge on the undertaking or property of the company;
- (g) a charge on calls made but not paid;
- (h) a charge on a ship or any share in a ship;
- (i) a charge on goodwill, on a patent or a licence under a patent, on a trademark or on a copyright or a licence under a copyright.

(3) In the case of a charge created out of the United Kingdom comprising property situate outside the United Kingdom, the delivery to and the receipt by the registrar of a copy verified in the prescribed manner of the instrument by which the charge is created or evidenced shall have the same effect for the purposes of this section as the delivery and receipt of the instrument itself, and twenty-one days after the date on which the instrument or copy could, in due course of post, and if despatched with due diligence, have been received in the United Kingdom shall be substituted for twenty-one days after the date of the creation of the charge as the time within which the particulars and instrument or copy are to be delivered to the registrar.

(4) Where a charge is created in the United Kingdom but comprises property outside the United Kingdom, the instrument creating or purporting to create the charge may be sent for registration under this section notwithstanding that further proceedings may be necessary to make the charge valid or effectual according to the law of the country in which the property is situate.

(5) Where a charge comprises property situate in Scotland or Northern Ireland and registration in the country where the property is situate is necessary to make the charge valid or effectual according to the law of that country, the delivery to and the receipt by the registrar of a copy verified in the prescribed manner of the instrument by which the charge is created or evidenced, together with a certificate in the prescribed form stating that the charge was presented for registration in Scotland or Northern Ireland, as the case may be, on the date on which it was so presented shall, for the purposes of this section, have the same effect as the delivery and receipt of the instrument itself.

(6) Where a negotiable instrument has been given to secure the payment of any book debts of a company the deposit of the instrument for the purpose of securing an advance to the company shall not, for the purposes of this section, be treated as a charge on those book debts.

(7) The holding of debentures entitling the holder to a charge on land shall not for the purposes of this section be deemed to be an interest in land.

(8) Where a series of debentures containing, or giving by reference to any other instrument, any charge to the benefit of which the debenture holders of that series are entitled *pari passu* is created by a company, it shall, for the purposes of this section, be sufficient if there are delivered to or received by the registrar, within twenty-one days after the execution of the deed containing the charge or, if there is no such deed, after the execution of any debentures of the series, the following particulars:—

- (a) the total amount secured by the whole series; and
 - (b) the dates of the resolutions authorising the issue of the series and the date of the covering deed, if any, by which the security is created or defined; and
 - (c) a general description of the property charged; and
 - (d) the names of the trustees, if any, for the debenture holders;
- together with the deed containing the charge, or, if there is no such deed, one of the debentures of the series:

Provided that, where more than one issue is made of debentures in the series, there shall be sent to the registrar for entry in the register particulars of the date and amount of each issue, but an omission to do this shall not effect the validity of the debentures issued.

(9) Where any commission, allowance or discount has been paid or made either directly or indirectly by a company to any person in consideration of his subscribing or agreeing to subscribe, whether absolutely or conditionally, for any debentures of the company, or procuring or agreeing to procure subscriptions, whether absolute or conditional, for any such debentures, the particulars required to be sent for registration under this section shall include particulars as to the amount or rate per cent. of the commission, discount or allowance so paid or made, but omission to do this shall not affect the validity of the debentures issued:

Provided that the deposit of any debentures as security for any debt of the company shall not, for the purposes of this subsection, be treated as the issue of the debentures at a discount.

(10) In this Part of this Act—

- (a) the expression "charge" includes mortgage;

- (b) the expression "the fixed date" means in relation to the charges specified in paragraphs (a) to (f), both inclusive, of subsection (2) of this section, the first day of July, nineteen hundred and eight, and in relation to the charges specified in paragraphs (g) to (i), both inclusive, of the said subsection, the first day of November, nineteen hundred and twenty-nine.

Duty of company to register charges created by company.

96.—(1) It shall be the duty of a company to send to the registrar of companies for registration the particulars of every charge created by the company and of the issues of debentures of a series requiring registration under the last foregoing section, but registration of any such charge may be effected on the application of any person interested therein.

(2) Where registration is effected on the application of some person other than the company, that person shall be entitled to recover from the company the amount of any fees properly paid by him to the registrar on the registration.

(3) If any company makes default in sending to the registrar for registration the particulars of any charge created by the company or of the issues of debentures of a series requiring registration as aforesaid, then, unless the registration has been effected on the application of some other person, the company and every officer of the company who is in default shall be liable to a default fine of fifty pounds.

Duty of company to register charges existing on property acquired.

97.—(1) Where a company registered in England acquires any property which is subject to a charge of any such kind as would, if it had been created by the company after the acquisition of the property, have been required to be registered under this Part of this Act, the company shall cause the prescribed particulars of the charge, together with a copy (certified in the prescribed manner to be a correct copy) of the instrument, if any, by which the charge was created or is evidenced, to be delivered to the registrar of companies for registration in manner required by this Act within twenty-one days after the date on which the acquisition is completed:

Provided that, if the property is situate and the charge was created outside Great Britain, twenty-one days after the date on which the copy of the instrument could in due course of post, and if despatched with due diligence, have been received in the United Kingdom shall be substituted for twenty-one days after the completion of the acquisition as the time within which the particulars and the copy of the instrument are to be delivered to the registrar.

(2) If default is made in complying with this section, the company and every officer of the company who is in default shall be liable to a default fine of fifty pounds.

Register of charges to be kept by registrar of companies.

98.—(1) The registrar of companies shall keep, with respect to each company, a register in the prescribed form of all the charges requiring registration under this Part of this Act, and shall, on payment of such fee as may be specified by regulations made by the Board of Trade, enter in the register with respect to such charges the following particulars:—

- (a) in the case of a charge to the benefit of which the holders of a series of debentures are entitled, such particulars as are specified in subsection (8) of section ninety-five of this Act;

(b) in the case of any other charge—

(i) if the charge is a charge created by the company, the date of its creation, and if the charge was a charge existing on property acquired by the company, the date of the acquisition of the property; and

(ii) the amount secured by the charge; and

(iii) short particulars of the property charged; and

(iv) the persons entitled to the charge.

(2) The registrar shall give a certificate under his hand of the registration of any charge registered in pursuance of this Part of this Act, stating the amount thereby secured, and the certificate shall be conclusive evidence that the requirements of this Part of this Act as to registration have been complied with.

(3) The register kept in pursuance of this section shall be open to inspection by any person on payment of such fee, not exceeding one shilling for each inspection as may be specified by regulations made by the Board of Trade.

(4) The powers to make regulations conferred by this section on the Board of Trade shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

99.—(1) The company shall cause a copy of every certificate of registration given under the last foregoing section to be endorsed on every debenture or certificate of debenture stock which is issued by the company and the payment of which is secured by the charge so registered: Endorsement of certificate of registration on debentures.

Provided that nothing in this subsection shall be construed as requiring a company to cause a certificate of registration of any charge so given to be endorsed on any debenture or certificate of debenture stock issued by the company before the charge was created.

(2) If any person knowingly and wilfully authorises or permits the delivery of any debenture or certificate of debenture stock which under the provisions of this section is required to have endorsed on it a copy of a certificate of registration without the copy being so endorsed upon it, he shall, without prejudice to any other liability, be liable to a fine not exceeding one hundred pounds.

100.—The registrar of companies, on evidence being given to his satisfaction with respect to any registered charge:— Entries of satisfaction and release of property from charge.

(a) that the debt for which the charge was given has been paid or satisfied in whole or in part; or

(b) that part of the property or undertaking charged has been released from the charge or has ceased to form part of the company's property or undertaking;

may enter on the register a memorandum of satisfaction in whole or in part, or of the fact that part of the property or undertaking has been released from the charge or has ceased to form part of the company's property or undertaking, as the case may be, and where he enters a memorandum of satisfaction in whole he shall, if required, furnish the company with a copy thereof.

Rectification
of register of
charges.

101.—The court, on being satisfied that the omission to register a charge within the time required by this Act or that the omission or mis-statement of any particular with respect to any such charge or in a memorandum of satisfaction was accidental, or due to inadvertence or to some other sufficient cause, or is not of a nature to prejudice the position of creditors or shareholders of the company, or that on other grounds it is just and equitable to grant relief, may, on the application of the company or any person interested, and on such terms and conditions as seem to the court just and expedient, order that the time for registration shall be extended, or, as the case may be, that the omission or mis-statement shall be rectified.

Registration
enforcement
of security.

102.—(1) If any person obtains an order for the appointment of a receiver or manager of the property of a company, or appoints such a receiver or manager under any powers contained in any instrument, he shall, within seven days from the date of the order or of the appointment under the said powers, give notice of the fact to the registrar of companies, and the registrar shall, on payment of such fee as may be specified by regulations made by the Board of Trade, enter the fact in the register of charges.

(2) Where any person appointed receiver or manager of the property of a company under the powers contained in any instrument ceases to act as such receiver or manager, he shall, on so ceasing, give the registrar of companies notice to that effect, and the registrar shall enter the notice in the register of charges.

(3) If any person makes default in complying with the requirements of this section, he shall be liable to a fine not exceeding five pounds for every day during which the default continues.

(4) The power conferred by this section on the Board of Trade shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

*Provisions as to Company's Register of Charges and as to Copies of
Instruments creating Charges.*

Copies of
instruments
creating charges
to be kept by
company.

103.—Every company shall cause a copy of every instrument creating any charge requiring registration under this Part of this Act to be kept at the registered office of the company:

Provided that, in the case of a series of uniform debentures, a copy of one debenture of the series shall be sufficient.

Company's
register of
charges.

104.—(1) Every limited company shall keep at the registered office of the company a register of charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or any property of the company, giving in each case a short description of the property charged, the amount of the charge, and, except in the case of securities to bearer, the names of the persons entitled thereto.

(2) If any officer of the company knowingly and wilfully authorises or permits the omission of any entry required to be made in pursuance of this section, he shall be liable to a fine not exceeding fifty pounds.

105.—(1) The copies of instruments creating any charge requiring registration under this Part of this Act with the registrar of companies, and the register of charges kept in pursuance of the last foregoing section, shall be open during business hours (but subject to such reasonable restrictions as the company in general meeting may impose, so that not less than two hours in each day shall be allowed for inspection) to the inspection of any creditor or member of the company without fee, and the register of charges shall also be open to the inspection of any other person on payment of such fee, not exceeding one shilling for each inspection, as the company may prescribe.

Right to inspect copies of instruments creating mortgages and charges and company's register of charges.

(2) If inspection of the said copies or register is refused, every officer of the company who is in default shall be liable to a fine not exceeding five pounds and a further fine not exceeding two pounds for every day during which the refusal continues.

(3) If any such refusal occurs in relation to a company registered in England, the court may by order compel an immediate inspection of the copies or register.

Application of Part III to Companies incorporated outside England.

106.—The provisions of this Part of this Act shall extend to charges on property in England which are created, and to charges on property in England which is acquired, by a company (whether a company within the meaning of this Act or not) incorporated outside England which has an established place of business in England.

Application of Part III to charges created, and property subject to charge acquired, by company incorporated outside England.

Annual Return.

124.—(1) Every company having a share capital shall, once at least in every year, make a return containing with respect to the registered office of the company, registers of members and debenture holders, shares and debentures, indebtedness, past and present members and directors and secretary, the matters specified in Part I of the Sixth Schedule to this Act, and the said return shall be in the form set out in Part II of that Schedule or as near thereto as circumstances admit: Provided that—

Annual return to be made by company having a share capital.

- (a) a company need not make a return under this subsection either in the year of its incorporation or, if it is not required by section one hundred and thirty-one of this Act to hold an annual general meeting during the following year, in that year;
- (b) where the company has converted any of its shares into stock and given notice of the conversion to the registrar of companies, the list referred to in paragraph 5 of Part I of the said Sixth Schedule must state the amount of stock held by each of the existing members instead of the amount of shares and the particulars relating to shares required by that paragraph;
- (c) the return may, in any year, if the return for either of the two immediately preceding years has given as at the date of that return the full particulars required by the said paragraph 5, give only such of the particulars required by that paragraph as relate to persons ceasing to be or becoming members since the date of the last return and to shares transferred since that date or to changes as compared with that date in the amount of stock held by a member; and

- (d) the annual return of a company made next after the expiry of paragraph (1) of regulation three of the Defence (Companies) Regulations, 1940 (under which the annual return of a company having a share capital need not contain any list of members, except in the case of a company's first annual return or of a private company), need not if that paragraph applied to the annual return last made by the company, give the particulars required by the said paragraph 5 as to past members of the company or as to shares transferred.
- (2) In the case of a company keeping a dominion register—
 - (a) references in proviso (c) to the foregoing subsection to the particulars required by the said paragraph 5 shall be taken as not including any such particulars contained in the dominion register, in so far as copies of the entries containing those particulars are not received at the registered office of the company before the date when the return in question is made; and
 - (b) where an annual return is made between the date when any entries are made in the dominion register and the date when copies of those entries are received at the registered office of the company, the particulars contained in those entries, so far as relevant to an annual return, shall be included in the next or a subsequent annual return as may be appropriate having regard to the particulars included in that return with respect to the company's register of members.
- (3) If a company fails to comply with this section, the company and every officer of the company who is in default shall be liable to a default fine.
- (4) For the purposes of this section and of Part I of the Sixth Schedule to this Act the expressions "director" and "officer" shall include any person in accordance with whose directions or instructions the directors of the company are accustomed to act.

Annual return to be made by company not having a share capital.

125.—(1) Every company not having a share capital shall once at least in every calendar year make a return stating—

- (a) the address of the registered office of the company;
- (b) in a case in which the register of members is, under the provisions of this Act, kept elsewhere than at that office, the address of the place where it is kept;
- (c) in a case in which any register of holders of debentures of the company or any duplicate of any such register or part of any such register is, under the provisions of this Act, kept, in England in the case of a company registered in England or in Scotland in the case of a company registered in Scotland, elsewhere than at the registered office of the company, the address of the place where it is kept;
- (d) all such particulars with respect to the persons who at the date of the return are the directors of the company and any person who at that date is secretary of the company as are by this Act required to be contained with respect to directors and the secretary respectively in the register of directors and secretaries of a company:

Provided that a company need not make a return under this subsection either in the year of its incorporation or, if it is not required

by section one hundred and thirty-one of this Act to hold an annual general meeting during the following year, in that year.

(2) There shall be annexed to the return a statement containing particulars of the total amount of the indebtedness of the company in respect of all mortgages and charges which are required (or, in the case of a company registered in Scotland, which, if the company had been registered in England, would be required) to be registered with the registrar of companies under this Act, or which would have been required so to be registered if created after the first day of July, nineteen hundred and eight.

(3) If a company fails to comply with this section, the company and every officer of the company who is in default shall be liable to a default fine.

(4) For the purposes of this section the expressions "officer" and "director" shall include any person in accordance with whose directions or instructions the directors of the company are accustomed to act.

126.—(1) The annual return must be completed within forty-two days after the annual general meeting for the year, whether or not that meeting is the first or only ordinary general meeting, or the first or only general meeting, of the company in the year, and the company must forthwith forward to the registrar of companies a copy signed both by a director and by the secretary of the company. Time for completion of annual return.

(2) If a company fails to comply with this section, the company and every officer of the company who is in default shall be liable to a default fine.

For the purposes of this subsection the expression "officer" shall include any person in accordance with whose directions or instructions the directors of the company are accustomed to act.

127.—(1) Subject to the provisions of this Act, there shall be annexed to the annual return— Documents to be annexed to annual return.

- (a) a written copy, certified both by a director and by the secretary of the company to be a true copy, of every balance sheet laid before the company in general meeting during the period to which the return relates (including every document required by law to be annexed to the balance sheet); and
- (b) a copy, certified as aforesaid, of the report of the auditors on, and of the report of the directors accompanying, each such balance sheet;

and where any such balance sheet or document required by law to be annexed thereto is in a foreign language, there shall be annexed to that balance sheet a translation in English of the balance sheet or document certified in the prescribed manner to be a correct translation.

(2) If any such balance sheet as aforesaid or document required by law to be annexed thereto did not comply with the requirements of the law as in force at the date of the audit with respect to the form of balance sheets or documents aforesaid, as the case may be, there shall be made such additions to and corrections in the copy as would have been required to be made in the balance sheet or document in order to make it comply with the said requirements, and the fact that the copy has been so amended shall be stated thereon.

(3) If a company fails to comply with this section, the company and every officer of the company who is in default shall be liable to a default fine.

For the purposes of this subsection, the expression "officer" shall include any person in accordance with whose directions or instructions the directors of the company are accustomed to act.

(4) This section shall not apply to an assurance company which has complied with the provisions of subsection (4) of section seven of the Assurance Companies Act, 1909.

9 Edw. 7 c. 49.

Exemption, in certain cases, of private companies, from requirements of s. 127.

129.—(1) A private company shall be excepted from the requirements imposed by section one hundred and twenty-seven of this Act if, but only if,—

- (a) the conditions mentioned in the next following subsection are satisfied at the date of the return and have been satisfied at all times since the commencement of this Act; and
- (b) there is sent with the return a certificate, signed by the persons signing the certificates required to be so sent by the last foregoing section, that to the best of their knowledge and belief the said conditions are and have been satisfied as aforesaid:

Provided that if at any time it is shown that the said conditions are then satisfied in the case of any private company, the Board of Trade may on the application of the company's directors direct that, in relation to any subsequent annual returns of the company, it shall not be necessary for the said conditions to have been satisfied before that time, and the certificates sent with those returns shall in that event relate only to the period since that time.

(2) The said conditions are—

- (a) that the conditions contained in the Seventh Schedule to this Act are satisfied as to the persons interested in the company's shares and debentures; and
- (b) that the number of persons holding debentures of the company is not more than fifty (joint holders being treated as a single person); and
- (c) that no body corporate is a director of the company and neither the company nor any of the directors is party or privy to any arrangement whereby the policy of the company is capable of being determined by persons other than the directors, members and debenture holders or trustees for debenture holders.

(3) A prosecution shall not be instituted in England in respect of any failure of a private company to comply with section one hundred and twenty-seven of this Act except by or with the consent of the Board of Trade.

(4) Any reference in this Act to an exempt private company shall be construed as referring to a company with respect to which the conditions mentioned in subsection (2) of this section are satisfied and have been satisfied at all times since the commencement of this Act or since the giving by the Board of Trade of a direction under the proviso to subsection (1) of this section.

(5) References in this section to the said conditions having been satisfied since the commencement of this Act, shall, in relation to a company first registered after the commencement of this Act, be construed as referring to the conditions having been satisfied since the company's registration.

131.—(1) Every company shall in each year hold a general meeting as its annual general meeting in addition to any other meetings in that year, and shall specify the meeting as such in the notices calling it; and not more than fifteen months shall elapse between the date of one annual general meeting of a company and that of the next: Annual general meeting.

Provided that, so long as a company holds its first annual general meeting within eighteen months of its incorporation, it need not hold it in the year of its incorporation or in the following year.

(2) If default is made in holding a meeting of the company in accordance with the foregoing subsection, the Board of Trade may, on the application of any member of the company, call, or direct the calling of, a general meeting of the company and give such ancillary or consequential directions as the Board think expedient, including directions modifying or supplementing, in relation to the calling, holding and conducting of the meeting, the operation of the company's articles; and it is hereby declared that the directions that may be given under this subsection include a direction that one member of the company present in person or by proxy shall be deemed to constitute a meeting.

(3) A general meeting held in pursuance of the last foregoing subsection shall, subject to any directions of the Board of Trade, be deemed to be an annual general meeting of the company; but, where a meeting so held is not held in the year in which the default in holding the company's annual general meeting occurred, the meeting so held shall not be treated as the annual general meeting for the year in which it is held unless at that meeting the company resolves that it shall be so treated.

(4) Where a company resolves that a meeting shall be so treated, a copy of the resolution shall, within fifteen days after the passing thereof, be forwarded to the registrar of companies and recorded by him.

(5) If default is made in holding a meeting of the company in accordance with subsection (1) of this section, or in complying with any directions of the Board of Trade under subsection (2) thereof, the company and every officer of the company who is in default shall be liable to a fine not exceeding fifty pounds, and if default is made in complying with subsection (4) of this section, the company and every officer of the company who is in default shall be liable to a default fine of two pounds.

133.—(1) Any provision of a company's articles shall be void in so far as it provides for the calling of a meeting of the company (other than an adjourned meeting) by a shorter notice than— Length of notice for calling meetings.

(a) in the case of the annual general meeting, twenty-one days' notice in writing; and

(b) in the case of a meeting other than an annual general meeting or a meeting for the passing of a special resolution, fourteen days' notice in writing in the case of a company other than an unlimited company and seven days' notice in writing in the case of an unlimited company.

(2) Save in so far as the articles of a company make other provision in that behalf (not being a provision avoided by the foregoing subsection) a meeting of the company (other than an adjourned meeting) may be called—

- (a) in the case of the annual general meeting, by twenty-one days' notice in writing; and
- (b) in the case of a meeting other than an annual general meeting or a meeting for the passing of a special resolution, by fourteen days' notice in writing in the case of a company other than an unlimited company and by seven days' notice in writing in the case of an unlimited company.

(3) A meeting of a company shall, notwithstanding that it is called by shorter notice than that specified in the last foregoing subsection or in the company's articles, as the case may be, be deemed to have been duly called if it is so agreed—

- (a) in the case of a meeting called as the annual general meeting, by all the members entitled to attend and vote thereat; and
- (b) in the case of any other meeting, by a majority in number of the members having a right to attend and vote at the meeting, being a majority together holding not less than ninety-five per cent. in nominal value of the shares giving a right to attend and vote at the meeting, or, in the case of a company not having a share capital, together representing not less than ninety-five per cent. of the total voting rights at that meeting of all the members.

Circulation
of members'
resolutions, &c.

140.—(1) Subject to the following provisions of this section it shall be the duty of a company, on the requisition in writing of such number of members as is hereinafter specified and (unless the company otherwise resolves) at the expense of the requisitionists,—

- (a) to give to members of the company entitled to receive notice of the next annual general meeting notice of any resolution which may properly be moved and is intended to be moved at that meeting;
- (b) to circulate to members entitled to have notice of any general meeting sent to them any statement of not more than one thousand words with respect to the matter referred to in any proposed resolution or the business to be dealt with at that meeting.

(2) The number of members necessary for a requisition under the foregoing subsection shall be—

- (a) any number of members representing not less than one twentieth of the total voting rights of all the members having at the date of the requisition a right to vote at the meeting to which the requisition relates; or
- (b) not less than one hundred members holding shares in the company on which there has been paid up an average sum, per member, of not less than one hundred pounds.

(3) Notice of any such resolution shall be given, and any such statement shall be circulated, to members of the company entitled to have notice of the meeting sent to them by serving a copy of the resolution or statement on each such member in any manner permitted for service of notice of the meeting, and notice of any such resolution

shall be given to any other member of the company by giving notice of the general effect of the resolution in any manner permitted for giving him notice of meetings of the company:

Provided that the copy shall be served, or notice of the effect of the resolution shall be given, as the case may be, in the same manner and, so far as practicable, at the same time as notice of the meeting and, where it is not practicable for it to be served or given at that time, it shall be served or given as soon as practicable thereafter.

(4) A company shall not be bound under this section to give notice of any resolution or to circulate any statement unless—

(a) a copy of the requisition signed by the requisitionists (or two or more copies which between them contain the signatures of all the requisitionists) is deposited at the registered office of the company—

(i) in the case of a requisition requiring notice of a resolution, not less than six weeks before the meeting; and

(ii) in the case of any other requisition, not less than one week before the meeting; and

(b) there is deposited or tendered with the requisition a sum reasonably sufficient to meet the company's expenses in giving effect thereto:

Provided that if, after a copy of a requisition requiring notice of a resolution has been deposited at the registered office of the company, an annual general meeting is called for a date six weeks or less after the copy has been deposited, the copy though not deposited within the time required by this subsection shall be deemed to have been properly deposited for the purposes thereof.

(5) The company shall also not be bound under this section to circulate any statement if, on the application either of the company or of any other person who claims to be aggrieved, the court is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter; and the court may order the company's costs on an application under this section to be paid in whole or in part by the requisitionists, notwithstanding that they are not parties to the application.

(6) Notwithstanding anything in the company's articles, the business which may be dealt with at an annual general meeting shall include any resolution of which notice is given in accordance with this section, and for the purposes of this subsection notice shall be deemed to have been so given notwithstanding the accidental omission, in giving it, of one or more members.

(7) In the event of any default in complying with the provisions of this section, every officer of the company who is in default shall be liable to a fine not exceeding five hundred pounds.

Accounts and Audit.

147.—(1) Every company shall cause to be kept proper books of Keeping of books of account.
account with respect to—

- (a) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;
- (b) all sales and purchases of goods by the company;
- (c) the assets and liabilities of the company.

(2) For the purposes of the foregoing subsection, proper books of account shall not be deemed to be kept with respect to the matters aforesaid if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

(3) The books of account shall be kept at the registered office of the company or at such other place as the directors think fit, and shall at all times be open to inspection by the directors:

Provided that if books of account are kept at a place outside Great Britain there shall be sent to, and kept at a place in, Great Britain and be at all times open to inspection by the directors such accounts and returns with respect to the business dealt with in the books of account so kept as will disclose with reasonable accuracy the financial position of that business at intervals not exceeding six months and will enable to be prepared in accordance with this Act the company's balance sheet, its profit and loss account or income and expenditure account, and any document annexed to any of those documents giving information which is required by this Act and is thereby allowed to be so given.

(4) If any person being a director of a company fails to take all reasonable steps to secure compliance by the company with the requirements of this section, or has by his own wilful act been the cause of any default by the company thereunder, he shall, in respect of each offence, be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding two hundred pounds:

Provided that—

- (a) in any proceedings against a person in respect of an offence under this section consisting of a failure to take reasonable steps to secure compliance by the company with the requirements of this section, it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that those requirements were complied with and was in a position to discharge that duty; and
- (b) a person shall not be sentenced to imprisonment for such an offence unless, in the opinion of the court dealing with the case, the offence was committed wilfully.

Profit and loss
account and
balance sheet.

148.—(1) The directors of every company shall at some date not later than eighteen months after the incorporation of the company and subsequently once at least in every calendar year lay before the company in general meeting a profit and loss account or, in the case of a company not trading for profit, an income and expenditure account for the period, in the case of the first account, since the incorporation of the company, and, in any other case, since the preceding account, made up to a date not earlier than the date of the meeting by more than nine months, or, in the case of a company carrying on business or having interests abroad, by more than twelve months:

Provided that the Board of Trade, if for any special reason they think fit so to do, may, in the case of any company, extend the period of eighteen months aforesaid, and in the case of any company and with respect to any year extend the periods of nine and twelve months aforesaid.

(2) The directors shall cause to be made out in every calendar year, and to be laid before the company in general meeting, a balance sheet as at the date to which the profit and loss account or the income and expenditure account, as the case may be, is made up.

(3) If any person being a director of a company fails to take all reasonable steps to comply with the provisions of this section, he shall, in respect of each offence, be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding two hundred pounds:

Provided that,—

- (a) in any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the provisions of this section were complied with and was in a position to discharge that duty; and
- (b) a person shall not be sentenced to imprisonment for such an offence unless, in the opinion of the court dealing with the case, the offence was committed wilfully.

149.—(1) Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.

General provisions as to contents and form of accounts.

(2) A company's balance sheet and profit and loss account shall comply with the requirements of the Eighth Schedule to this Act, so far as applicable thereto.

(3) Save as expressly provided in the following provisions of this section or in Part III of the said Eighth Schedule, the requirements of the last foregoing subsection and the said Eighth Schedule shall be without prejudice either to the general requirements of subsection (1) of this section or to any other requirements of this Act.

(4) The Board of Trade may, on the application or with the consent of a company's directors, modify in relation to that company any of the requirements of this Act as to the matters to be stated in a company's balance sheet or profit and loss account (except the requirements of subsection (1) of this section) for the purpose of adapting them to the circumstances of the company.

(5) Subsections (1) and (2) of this section shall not apply to a company's profit and loss account if—

- (a) the company has subsidiaries; and
- (b) the profit and loss account is framed as a consolidated profit and loss account dealing with all or any of the company's subsidiaries as well as the company and—
 - (i) complies with the requirements of this Act relating to consolidated profit and loss accounts; and
 - (ii) shows how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the company.

(6) If any person being a director of a company fails to take all reasonable steps to secure compliance as respects any accounts laid

before the company in general meeting with the provisions of this section and with the other requirements of this Act as to the matters to be stated in accounts, he shall, in respect of each offence, be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding two hundred pounds:

Provided that,—

- (a) in any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the said provisions or the said other requirements, as the case may be, were complied with and was in a position to discharge that duty; and
 - (b) a person shall not be sentenced to imprisonment for any such offence unless, in the opinion of the court dealing with the case, the offence was committed wilfully.
- (7) For the purposes of this section and the following provisions of this Act, except where the context otherwise requires,—
- (a) any reference to a balance sheet or profit and loss account shall include any notes thereon or document annexed thereto giving information which is required by this Act and is thereby allowed to be so given; and
 - (b) any reference to a profit and loss account shall be taken, in the case of a company not trading for profit, as referring to its income and expenditure account, and references to profit or to loss and, if the company has subsidiaries, references to a consolidated profit and loss account shall be construed accordingly.

Obligation to lay group accounts before holding company.

150.—(1) Where at the end of its financial year a company has subsidiaries, accounts or statements (in this Act referred to as “group accounts”) dealing as hereinafter mentioned with the state of affairs and profit or loss of the company and the subsidiaries shall, subject to the next following subsection, be laid before the company in general meeting when the company’s own balance sheet and profit and loss account are so laid.

(2) Notwithstanding anything in the foregoing subsection—

- (a) group accounts shall not be required where the company is at the end of its financial year the wholly owned subsidiary of another body corporate incorporated in Great Britain; and
- (b) group accounts need not deal with a subsidiary of the company if the company’s directors are of opinion that—
 - (i) it is impracticable, or would be of no real value to members of the company, in view of the insignificant amounts involved, or would involve expense or delay out of proportion to the value to members of the company; or
 - (ii) the result would be misleading, or harmful to the business of the company or any of its subsidiaries; or
 - (iii) the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking;

and, if the directors are of such an opinion about each of the company’s subsidiaries, group accounts shall not be required:

Provided that the approval of the Board of Trade shall be required for not dealing in group accounts with a subsidiary on the ground that the result would be harmful or on the ground of the difference between the business of the holding company and that of the subsidiary.

(3) If any person being a director of a company fails to take all reasonable steps to secure compliance as respects the company with the provisions of this section, he shall, in respect of each offence, be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding two hundred pounds:

Provided that,—

- (a) in any proceedings against a person in respect of an offence under this section, it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the requirements of this section were complied with and was in a position to discharge that duty; and
 - (b) a person shall not be sentenced to imprisonment for an offence under this section unless, in the opinion of the court dealing with the case, the offence was committed wilfully.
- (4) For the purposes of this section a body corporate shall be deemed to be the wholly owned subsidiary of another if it has no members except that other and that other's wholly owned subsidiaries and its or their nominees.

151.—(1) Subject to the next following subsection, the group accounts laid before a holding company shall be consolidated accounts comprising—

Form of group accounts.

- (a) a consolidated balance sheet dealing with the state of affairs of the company and all the subsidiaries to be dealt with in group accounts;
 - (b) a consolidated profit and loss account dealing with the profit or loss of the company and those subsidiaries.
- (2) If the company's directors are of opinion that it is better for the purpose—
- (a) of presenting the same or equivalent information about the state of affairs and profit or loss of the company and those subsidiaries; and
 - (b) of so presenting it that it may be readily appreciated by the company's members;

the group accounts may be prepared in a form other than that required by the foregoing subsection, and in particular may consist of more than one set of consolidated accounts dealing respectively with the company and one group of subsidiaries and with other groups of subsidiaries or of separate accounts dealing with each of the subsidiaries, or of statements expanding the information about the subsidiaries in the company's own accounts, or any combination of those forms.

(3) The group accounts may be wholly or partly incorporated in the company's own balance sheet and profit and loss account.

152.—(1) The group accounts laid before a company shall give a true and fair view of the state of affairs and profit or loss of the company and the subsidiaries dealt with thereby as a whole, so far as concerns members of the company.

Contents of group accounts.

(2) Where the financial year of a subsidiary does not coincide with that of the holding company, the group accounts shall, unless the Board of Trade on the application or with the consent of the holding company's directors otherwise direct, deal with the subsidiary's state of affairs as at the end of its financial year ending with or last before that of the holding company, and with the subsidiary's profit or loss for that financial year.

(3) Without prejudice to subsection (1) of this section, the group accounts, if prepared as consolidated accounts, shall comply with the requirements of the Eighth Schedule to this Act, so far as applicable thereto, and if not so prepared shall give the same or equivalent information:

Provided that the Board of Trade may, on the application or with the consent of a company's directors, modify the said requirements in relation to that company for the purpose of adapting them to the circumstances of the company.

Financial year
of holding
company and
subsidiary.

153.—(1) A holding company's directors shall secure that except where in their opinion there are good reasons against it, the financial year of each of its subsidiaries shall coincide with the company's own financial year.

(2) Where it appears to the Board of Trade desirable for a holding company or a holding company's subsidiary to extend its financial year so that the subsidiary's financial year may end with that of the holding company, and for that purpose to postpone the submission of the relevant accounts to a general meeting from one calendar year to the next, the Board may on the application or with the consent of the directors of the company whose financial year is to be extended direct that, in the case of that company, the submission of accounts to a general meeting, the holding of an annual general meeting or the making of an annual return shall not be required in the earlier of the said calendar years.

Meaning of
"holding
company" and
"subsidiary."

154.—(1) For the purposes of this Act, a company shall, subject to the provisions of subsection (3) of this section, be deemed to be a subsidiary of another if, but only if,—

(a) that other either—

(i) is a member of it and controls the composition of its board of directors; or

(ii) holds more than half in nominal value of its equity share capital; or

(b) the first-mentioned company is a subsidiary of any company which is that other's subsidiary.

(2) For the purposes of the foregoing subsection, the composition of a company's board of directors shall be deemed to be controlled by another company if, but only if, that other company by the exercise of some power exercisable by it without the consent or concurrence of any other person can appoint or remove the holders of all or a majority of the directorships; but for the purposes of this provision that other company shall be deemed to have power to appoint to a directorship with respect to which any of the following conditions is satisfied, that is to say—

(a) that a person cannot be appointed thereto without the exercise in his favour by that other company of such a power as aforesaid; or

- (b) that a person's appointment thereto follows necessarily from his appointment as director of that other company; or
 - (c) that the directorship is held by that other company itself or by a subsidiary of it.
- (3) In determining whether one company is a subsidiary of another—
- (a) any shares held or power exercisable by that other in a fiduciary capacity shall be treated as not held or exercisable by it;
 - (b) subject to the two following paragraphs, any shares held or power exercisable—
 - (i) by any person as a nominee for that other (except where that other is concerned only in a fiduciary capacity); or
 - (ii) by, or by a nominee for, a subsidiary of that other, not being a subsidiary which is concerned only in a fiduciary capacity;
 shall be treated as held or exercisable by that other;
 - (c) any shares held or power exercisable by any person by virtue of the provisions of any debentures of the first-mentioned company or of a trust deed for securing any issue of such debentures shall be disregarded;
 - (d) any shares held or power exercisable by, or by a nominee for, that other or its subsidiary (not being held or exercisable as mentioned in the last foregoing paragraph) shall be treated as not held or exercisable by that other if the ordinary business of that other or its subsidiary, as the case may be, includes the lending of money and the shares are held or power is exercisable as aforesaid by way of security only for the purposes of a transaction entered into in the ordinary course of that business.
- (4) For the purposes of this Act, a company shall be deemed to be another's holding company if, but only if, that other is its subsidiary.
- (5) In this section the expression "company" includes any body corporate, and the expression "equity share capital" means, in relation to a company, its issued share capital excluding any part thereof which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution.

155.—(1) Every balance sheet of a company shall be signed on behalf of the board by two of the directors of the company, or, if there is only one director, by that director. Signing of
balance sheet.

(2) In the case of a banking company registered after the fifteenth day of August, eighteen hundred and seventy-nine, the balance sheet must be signed by the secretary or manager, if any, and where there are more than three directors of the company by at least three of those directors, and where there are not more than three directors by all the directors.

(3) If any copy of a balance sheet which has not been signed as required by this section is issued, circulated or published, the company and every officer of the company who is in default shall be liable to a fine not exceeding fifty pounds.

156.—(1) The profit and loss account and, so far as not incorporated in the balance sheet or profit and loss account, any group accounts laid before the company in general meeting, shall be annexed to the balance sheet, and the auditors' report shall be attached thereto. Accounts and
auditors' report
to be annexed to
balance sheet.

(2) Any accounts so annexed shall be approved by the board of directors before the balance sheet is signed on their behalf.

(3) If any copy of a balance sheet is issued, circulated or published without having annexed thereto a copy of the profit and loss account or any group accounts required by this section to be so annexed, or without having attached thereto a copy of the auditors' report, the company and every officer of the company who is in default shall be liable to a fine not exceeding fifty pounds.

Directors' report
to be attached to
balance sheet.

157.—(1) There shall be attached to every balance sheet laid before a company in general meeting a report by the directors with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid by way of dividend, and the amount, if any, which they propose to carry to reserves within the meaning of the Eighth Schedule to this Act.

(2) The said report shall deal, so far as is material for the appreciation of the state of the company's affairs by its members and will not in the directors' opinion be harmful to the business of the company or of any of its subsidiaries, with any change during the financial year in the nature of the company's business, or in the company's subsidiaries, or in the classes of business in which the company has an interest, whether as member of another company or otherwise.

(3) If any person being a director of a company fails to take all reasonable steps to comply with the provisions of subsection (1) of this section, he shall, in respect of each offence, be liable on summary conviction to imprisonment for a term not exceeding six months or to a fine not exceeding two hundred pounds:

Provided that,—

- (a) in any proceedings against a person in respect of an offence under the said subsection (1), it shall be a defence to prove that he had reasonable ground to believe and did believe that a competent and reliable person was charged with the duty of seeing that the provisions of that subsection were complied with and was in a position to discharge that duty; and
- (b) a person shall not be liable to be sentenced to imprisonment for such an offence unless, in the opinion of the court dealing with the case, the offence was committed wilfully.

Right to receive
copies of balance
sheets and
auditors' report.

158.—(1) A copy of every balance sheet, including every document required by law to be annexed thereto, which is to be laid before a company in general meeting, together with a copy of the auditors' report, shall, not less than twenty-one days before the date of the meeting, be sent to every member of the company (whether he is or is not entitled to receive notices of general meetings of the company), every holder of debentures of the company (whether he is or is not so entitled) and all persons other than members or holders of debentures of the company, being persons so entitled:

Provided that—

- (a) in the case of a company not having a share capital this subsection shall not require the sending of a copy of the documents aforesaid to a member of the company who is not entitled to receive notices of general meetings of the company or to a holder of debentures of the company who is not so entitled;

- (b) this subsection shall not require a copy of those documents to be sent—

(i) to a member of the company or a holder of debentures of the company, being in either case a person who is not entitled to receive notices of general meetings of the company and of whose address the company is unaware;

(ii) to more than one of the joint holders of any shares or debentures none of whom are entitled to receive such notices; or

(iii) in the case of joint holders of any shares or debentures some of whom are and some of whom are not entitled to receive such notices, to those who are not so entitled; and

- (c) if the copies of the documents aforesaid are sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by all the members entitled to attend and vote at the meeting.

(2) Any member of a company, whether he is or is not entitled to have sent to him copies of the company's balance sheets, and any holder of debentures of the company, whether he is or is not so entitled, shall be entitled to be furnished on demand without charge with a copy of the last balance sheet of the company, including every document required by law to be annexed thereto, together with a copy of the auditors' report on the balance sheet.

(3) If default is made in complying with subsection (1) of this section, the company and every officer of the company who is in default shall be liable to a fine not exceeding twenty pounds, and if, when any person makes a demand for any document with which he is by virtue of subsection (2) of this section entitled to be furnished, default is made in complying with the demand within seven days after the making thereof, the company and every officer of the company who is in default shall be liable to a default fine, unless it is proved that that person has already made a demand for and been furnished with a copy of the document.

(4) The foregoing provisions of this section shall not have effect in relation to a balance sheet of a private company laid before it before the commencement of this Act, and the right of any person to be furnished with a copy of any such balance sheet and the liability of the company in respect of a failure to satisfy that right shall be the same as they would have been if this Act had not passed.

159.—(1) Every company shall at each annual general meeting appoint an auditor or auditors to hold office from the conclusion of that, until the conclusion of the next, annual general meeting. Appointment and remuneration of auditors.

(2) At any annual general meeting a retiring auditor, however appointed, shall be reappointed without any resolution being passed unless—

- (a) he is not qualified for reappointment; or
- (b) a resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be reappointed; or
- (c) he has given the company notice in writing of his unwillingness to be reappointed:

Provided that where notice is given of an intended resolution to appoint some person or persons in place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with, the retiring auditor shall not be automatically re-appointed by virtue of this subsection.

(3) Where at an annual general meeting no auditors are appointed or reappointed, the Board of Trade may appoint a person to fill the vacancy.

(4) The company shall, within one week of the Board's power under the last foregoing subsection becoming exercisable, give them notice of that fact, and, if a company fails to give notice as required by this subsection, the company and every officer of the company who is in default shall be liable to a default fine.

(5) Subject as hereinafter provided, the first auditors of a company may be appointed by the directors at any time before the first annual general meeting, and auditors so appointed shall hold office until the conclusion of that meeting:

Provided that—

- (a) the company may at a general meeting remove any such auditors and appoint in their place any other persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than fourteen days before the date of the meeting; and
 - (b) if the directors fail to exercise their powers under this subsection, the company in general meeting may appoint the first auditors, and thereupon the said powers of the directors shall cease.
- (6) The directors may fill any casual vacancy in the office of auditor, but while any such vacancy continues, the surviving or continuing auditor or auditors, if any, may act.
- (7) The remuneration of the auditors of a company—
- (a) in the case of an auditor appointed by the directors or by the Board of Trade, may be fixed by the directors or by the Board, as the case may be;
 - (b) subject to the foregoing paragraph, shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

For the purposes of this subsection, any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration."

Provisions as to resolutions relating to appointment and removal of auditors.

160.—(1) Special notice shall be required for a resolution at a company's annual general meeting appointing as auditor a person other than a retiring auditor or providing expressly that a retiring auditor shall not be reappointed.

(2) On receipt of notice of such an intended resolution as aforesaid, the company shall forthwith send a copy thereof to the retiring auditor (if any).

(3) Where notice is given of such an intended resolution as aforesaid and the retiring auditor makes with respect to the intended resolution representations in writing to the company (not exceeding a reasonable

length) and requests their notification to members of the company, the company shall, unless the representations are received by it too late for it to do so,—

- (a) in any notice of the resolution given to members of the company, state the fact of the representations having been made; and
- (b) send a copy of the representations to every member of the company to whom notice of the meeting is sent (whether before or after receipt of the representations by the company);

and if a copy of the representations is not sent as aforesaid because received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representations shall be read out at the meeting:

Provided that copies of the representations need not be sent out and the representations need not be read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the court is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter; and the court may order the company's costs on an application under this section to be paid in whole or in part by the auditor, notwithstanding that he is not a party to the application.

(4) The last foregoing subsection shall apply to a resolution to remove the first auditors by virtue of subsection (5) of the last foregoing section as it applies in relation to a resolution that a retiring auditor shall not be reappointed.

161.—(1) A person shall not be qualified for appointment as auditor of a company unless either—

**Disqualification
for appointment
as auditor.**

- (a) he is a member of a body of accountants established in the United Kingdom and for the time being recognised for the purposes of this provision by the Board of Trade; or
- (b) he is for the time being authorised by the Board of Trade to be so appointed either as having similar qualifications obtained outside the United Kingdom or as having obtained adequate knowledge and experience in the course of his employment by a member of a body of accountants recognised for the purposes of the foregoing paragraph or as having before the sixth day of August, nineteen hundred and forty-seven, practised in Great Britain as an accountant:

Provided that this subsection shall not apply in the case of a private company which at the time of the auditor's appointment is an exempt private company.

(2) None of the following persons shall be qualified for appointment as auditor of a company—

- (a) an officer or servant of the company;
- (b) a person who is a partner of or in the employment of an officer or servant of the company;
- (c) a body corporate:

Provided that paragraph (b) of this subsection shall not apply in the case of a private company which at the time of the auditor's appointment is an exempt private company.

References in this subsection to an officer or servant shall be construed as not including references to an auditor.

(3) A person shall also not be qualified for appointment as auditor of a company if he is, by virtue of the last foregoing subsection, disqualified for appointment as auditor of any other body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company.

(4) Notwithstanding anything in the foregoing provisions of this section, a Scottish firm shall be qualified for appointment as auditor of a company if, but only if, all the partners are qualified for appointment as auditor thereof.

(5) Any body corporate which acts as auditor of a company shall be liable to a fine not exceeding one hundred pounds.

Auditors' report
and right of
access to books
and to attend
and be heard at
general meetings.

162.—(1) The auditors shall make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts laid before the company in general meeting during their tenure of office, and the report shall contain statements as to the matters mentioned in the Ninth Schedule to this Act.

(2) The auditors' report shall be read before the company in general meeting and shall be open to inspection by any member.

(3) Every auditor of a company shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the officers of the company such information and explanation as he thinks necessary for the performance of the duties of the auditors.

(4) The auditors of a company shall be entitled to attend any general meeting of the company and to receive all notices of and other communications relating to any general meeting which any member of the company is entitled to receive and to be heard at any general meeting which they attend on any part of the business of the meeting which concerns them as auditors.

Construction
of references
to documents
annexed to
accounts.

163.—References in this Act to a document annexed or required to be annexed to a company's accounts or any of them shall not include the directors' report or the auditors' report:

Provided that any information which is required by this Act to be given in accounts, and is thereby allowed to be given in a statement annexed, may be given in the directors' report instead of in the accounts and, if any such information is so given, the report shall be annexed to the accounts and this Act shall apply in relation thereto accordingly, except that the auditors shall report thereon only so far as it gives the said information.

Prohibition
of tax-free
payments
to directors.

189.—(1) It shall not be lawful for a company to pay a director remuneration (whether as director or otherwise) free of income tax or of income tax other than surtax, or otherwise calculated by reference to or varying with the amount of his income tax or his income tax other than surtax, or to or with the rate or standard rate of income tax, except under a contract which was in force on the eighteenth day of July, nineteen hundred and forty-five, and provides expressly, and not by reference to the articles, for payment of remuneration as aforesaid.

(2) Any provision contained in a company's articles, or in any contract other than such a contract as aforesaid, or in any resolution of a company or a company's directors, for payment to a director of remuneration as aforesaid shall have effect as if it provided for payment, as a gross sum subject to income tax and surtax, of the net sum for which it actually provides.

(3) This section shall not apply to remuneration due before the commencement of this Act or in respect of a period before the commencement of this Act.

190.—(1) It shall not be lawful for a company to make a loan to any person who is its director or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person:

Prohibition of loans to directors.

Provided that nothing in this section shall apply either—

- (a) to anything done by a company which is for the time being an exempt private company; or
- (b) to anything done by a subsidiary, where the director is its holding company; or
- (c) subject to the next following subsection, to anything done to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company or for the purpose of enabling him properly to perform his duties as an officer of the company; or
- (d) in the case of a company whose ordinary business includes the lending of money or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business.

(2) Proviso (c) to the foregoing subsection shall not authorise the making of any loan, or the entering into any guarantee, or the provision of any security, except either—

- (a) with the prior approval of the company given at a general meeting at which the purposes of the expenditure and the amount of the loan or the extent of the guarantee or security, as the case may be, are disclosed; or
- (b) on condition that, if the approval of the company is not given as aforesaid at or before the next following annual general meeting, the loan shall be repaid or the liability under the guarantee or security shall be discharged, as the case may be, within six months from the conclusion of that meeting.

(3) Where the approval of the company is not given as required by any such condition, the directors authorising the making of the loan, or the entering into the guarantee, or the provision of the security, shall be jointly and severally liable to indemnify the company against any loss arising therefrom.

196.—(1) In any accounts of a company laid before it in general meeting, or in a statement annexed thereto, there shall, subject to and in accordance with the provisions of this section, be shown so far as the information is contained in the company's books and papers or the company has the right to obtain it from the persons concerned—

Particulars in accounts of directors' salaries, pensions, &c.

- (a) the aggregate amount of the directors' emoluments;

- (b) the aggregate amount of directors' or past directors' pensions; and
 - (c) the aggregate amount of any compensation to directors or past directors in respect of loss of office.
- (2) The amount to be shown under paragraph (a) of subsection (1) of this section—
- (a) shall include any emoluments paid to or receivable by any person in respect of his services as director of the company or in respect of his services, while director of the company, as director of any subsidiary thereof or otherwise in connection with the management of the affairs of the company or any subsidiary thereof; and
 - (b) shall distinguish between emoluments in respect of services as director, whether of the company or its subsidiary, and other emoluments;

and for the purposes of this section the expression "emoluments," in relation to a director, includes fees and percentages, any sums paid by way of expenses allowance in so far as those sums are charged to United Kingdom income tax, any contribution paid in respect of him under any pension scheme and the estimated money value of any other benefits received by him otherwise than in cash.

(3) The amount to be shown under paragraph (b) of the said subsection (1)—

- (a) shall not include any pension paid or receivable under a pension scheme if the scheme is such that the contributions thereunder are substantially adequate for the maintenance of the scheme, but save as aforesaid shall include any pension paid or receivable in respect of any such services of a director or past director of the company as are mentioned in the last foregoing subsection, whether to or by him or, on his nomination or by virtue of dependence on or other connection with him, to or by any other person; and
- (b) shall distinguish between pensions in respect of services as director, whether of the company or its subsidiary, and other pensions;

and for the purposes of this section the expression "pension" includes any superannuation allowance, superannuation gratuity or similar payment, and the expression "pension scheme" means a scheme for the provision of pensions in respect of services as director or otherwise which is maintained in whole or in part by means of contributions, and the expression "contribution" in relation to a pension scheme means any payment (including an insurance premium) paid for the purposes of the scheme by or in respect of persons rendering services in respect of which pensions will or may become payable under the scheme, except that it does not include any payment in respect of two or more persons if the amount paid in respect of each of them is not ascertainable.

(4) The amount to be shown under paragraph (c) of the said subsection (1)—

- (a) shall include any sums paid to or receivable by a director or past director by way of compensation for the loss of office as director of the company or for the loss, while director of the

company or on or in connection with his ceasing to be a director of the company, of any other office in connection with the management of the company's affairs or of any office as director or otherwise in connection with the management of the affairs of any subsidiary thereof; and

- (b) shall distinguish between compensation in respect of the office of director, whether of the company or its subsidiary, and compensation in respect of other offices;

and for the purposes of this section references to compensation for loss of office shall include sums paid as consideration for or in connection with a person's retirement from office.

(5) The amounts to be shown under each paragraph of the said subsection (1)—

- (a) shall include all relevant sums paid by or receivable from—

- (i) the company; and
- (ii) the company's subsidiaries; and
- (iii) any other person;

except sums to be accounted for to the company or any of its subsidiaries or, by virtue of section one hundred and ninety-three of this Act, to past or present members of the company or any of its subsidiaries or any class of those members; and

- (b) shall distinguish, in the case of the amount to be shown under paragraph (c) of the said subsection (1), between the sums respectively paid by or receivable from the company, the company's subsidiaries and persons other than the company and its subsidiaries.

(6) The amounts to be shown under this section for any financial year shall be the sums receivable in respect of that year, whenever paid, or, in the case of sums not receivable in respect of a period, the sums paid during that year, so, however, that where—

- (a) any sums are not shown in the accounts for the relevant financial year on the ground that the person receiving them is liable to account therefor as mentioned in paragraph (a) of the last foregoing subsection, but the liability is thereafter wholly or partly released or is not enforced within a period of two years; or
- (b) any sums paid by way of expenses allowance are charged to United Kingdom income tax after the end of the relevant financial year;

those sums shall, to the extent to which the liability is released or not enforced or they are charged as aforesaid, as the case may be, be shown in the first accounts in which it is practicable to show them or in a statement annexed thereto, and shall be distinguished from the amounts to be shown therein apart from this provision.

(7) Where it is necessary so to do for the purpose of making any distinction required by this section in any amount to be shown thereunder, the directors may apportion any payments between the matters in respect of which they have been paid or are receivable in such manner as they think appropriate.

(8) If in the case of any accounts the requirements of this section are not complied with, it shall be the duty of the auditors of the company by whom the accounts are examined to include in their report

thereon, so far as they are reasonably able to do so, a statement giving the required particulars.

(9) In this section any reference to a company's subsidiary—

- (a) in relation to a person who is or was, while a director of the company, a director also, by virtue of the company's nomination, direct or indirect, of any other body corporate, shall, subject to the following paragraph, include that body corporate, whether or not it is or was in fact the company's subsidiary; and
- (b) shall for the purposes of subsections (2) and (3) be taken as referring to a subsidiary at the time the services were rendered, and for the purposes of subsection (4) be taken as referring to a subsidiary immediately before the loss of office as director of the company.

Particulars
in accounts
of loans to
officers, &c.

197.—(1) The accounts which, in pursuance of this Act, are to be laid before every company in general meeting shall, subject to the provisions of this section, contain particulars showing—

(a) the amount of any loans made during the company's financial year to—

(i) any officer of the company; or

(ii) any person who, after the making of the loan, became during that year an officer of the company;

by the company or a subsidiary thereof or by any other person under a guarantee from or on a security provided by the company or a subsidiary thereof (including any such loans which were repaid during that year); and

(b) the amount of any loans made in manner aforesaid to any such officer or person as aforesaid at any time before the company's financial year and outstanding at the expiration thereof.

(2) The foregoing subsection shall not require the inclusion in accounts of particulars of—

(a) a loan made in the ordinary course of its business by the company or a subsidiary thereof, where the ordinary business of the company or, as the case may be, the subsidiary, includes the lending of money; or

(b) a loan made by the company or a subsidiary thereof to an employee of the company or subsidiary, as the case may be, if the loan does not exceed two thousand pounds and is certified by the directors of the company or subsidiary, as the case may be, to have been made in accordance with any practice adopted or about to be adopted by the company or subsidiary with respect to loans to its employees;

not being, in either case, a loan made by the company under a guarantee from or on a security provided by a subsidiary thereof or a loan made by a subsidiary of the company under a guarantee from or on a security provided by the company or any other subsidiary thereof.

(3) If in the case of any such accounts as aforesaid the requirements of this section are not complied with, it shall be the duty of the auditors of the company by whom the accounts are examined to include in their report on the balance sheet of the company, so far as they are reasonably able to do so, a statement giving the required particulars.

(4) References in this section to a subsidiary shall be taken as referring to a subsidiary at the end of the company's financial year (whether or not a subsidiary at the date of the loan).

198.—(1) It shall be the duty of any director of a company to give notice to the company of such matters relating to himself as may be necessary for the purposes of sections one hundred and ninety-five and one hundred and ninety-six of this Act and of the last foregoing section except so far as it relates to loans made, by the company or by any other person under a guarantee from or on a security provided by the company, to an officer thereof.

General duty to make disclosure for purposes of three foregoing sections.

(2) Any such notice given for the purposes of the said section one hundred and ninety-five shall be in writing and, if it is not given at a meeting of the directors, the director giving it shall take reasonable steps to secure that it is brought up and read at the next meeting of directors after it is given.

(3) Subsection (1) of this section shall apply—

- (a) for the purposes of the last foregoing section, in relation to officers other than directors; and
- (b) for the purposes of the said section one hundred and ninety-six and the last foregoing section, in relation to persons who are or have at any time during the preceding five years been officers;

as it applies in relation to directors.

(4) Any person who makes default in complying with the foregoing provisions of this section shall be liable to a fine not exceeding fifty pounds.

Avoidance of Provisions in Articles or Contracts relieving Officers from Liability.

205.—Subject as hereinafter provided, any provision, whether contained in the articles of a company or in any contract with a company or otherwise, for exempting any officer of the company or any person (whether an officer of the company or not) employed by the company as auditor from, or indemnifying him against, any liability which by virtue of any rule of law would otherwise attach to him in respect of any negligence, default, breach of duty or breach of trust of which he may be guilty in relation to the company shall be void:

Provisions as to liability of officers and auditors.

Provided that—

- (a) nothing in this section shall operate to deprive any person of any exemption or right to be indemnified in respect of anything done or omitted to be done by him while any such provision was in force; and
- (b) notwithstanding anything in this section, a company may, in pursuance of any such provision as aforesaid, indemnify any such officer or auditor against any liability incurred by him in defending any proceedings, whether civil or criminal in which judgment is given in his favour or in which he is acquitted or in connection with any application under section four hundred and forty-eight of this Act in which relief is granted to him by the court.

Minorities.

Alternative
remedy to
winding up
in cases of
oppression.

210.—(1) Any member of a company who complains that the affairs of the company are being conducted in a manner oppressive to some part of the members (including himself) or, in a case falling within subsection (3) of section one hundred and sixty-nine of this Act, the Board of Trade, may make an application to the court by petition for an order under this section.

(2) If on any such petition the court is of opinion—

(a) that the company's affairs are being conducted as aforesaid; and

(b) that to wind up the company would unfairly prejudice that part of the members, but otherwise the facts would justify the making of a winding-up order on the ground that it was just and equitable that the company should be wound up;

the court may, with a view to bringing to an end the matters complained of, make such order as it thinks fit, whether for regulating the conduct of the company's affairs in future, or for the purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital, or otherwise.

(3) Where an order under this section makes any alteration in or addition to any company's memorandum or articles, then, notwithstanding anything in any other provision of this Act but subject to the provisions of the order, the company concerned shall not have power without the leave of the court to make any further alteration in or addition to the memorandum or articles inconsistent with the provisions of the order; but, subject to the foregoing provisions of this subsection, the alterations or additions made by the order shall be of the same effect as if duly made by resolution of the company and the provisions of this Act shall apply to the memorandum or articles as so altered or added to accordingly.

(4) An office copy of any order under this section altering or adding to, or giving leave to alter or add to, a company's memorandum or articles shall, within fourteen days after the making thereof, be delivered by the company to the registrar of companies for registration; and if a company makes default in complying with this subsection, the company and every officer of the company who is in default shall be liable to a default fine.

(5) In relation to a petition under this section, section three hundred and sixty-five of this Act shall apply as it applies in relation to a winding-up petition, and proceedings under this section shall, for the purposes of Part V of the Economy (Miscellaneous Provisions) Act, 1926, be deemed to be proceedings under this Act in relation to the winding up of companies.

Effect of
floating charge.

322.—(1) Where a company is being wound up, a floating charge on the undertaking or property of the company created within twelve months of the commencement of the winding up shall, unless it is proved that the company immediately after the creation of the charge was solvent, be invalid, except to the amount of any cash paid to the company at the time of or subsequently to the creation of, and in consideration for, the charge, together with interest on that amount

at the rate of five per cent. per annum or such other rate as may for the time being be prescribed by order of the Treasury:

Provided that, in relation to a charge created more than six months before the commencement of this Act, this section shall have effect with the substitution, for the words "twelve months," of the words "six months."

(2) The power conferred by this section on the Treasury shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

329.—If any officer or contributory of any company being wound up destroys, mutilates, alters or falsifies any books, papers or securities, or makes or is privy to the making of any false or fraudulent entry in any register, book of account or document belonging to the company with intent to defraud or deceive any person, he shall be guilty of a misdemeanour, and be liable to imprisonment for any term not exceeding two years, with or without hard labour. Penalty for falsification of books.

331.—(1) If where a company is wound up it is shown that proper books of account were not kept by the company throughout the period of two years immediately preceding the commencement of the winding up, or the period between the incorporation of the company and the commencement of the winding up, whichever is the shorter, every officer of the company who is in default shall, unless he shows that he acted honestly and that in the circumstances in which the business of the company was carried on the default was excusable, be liable on conviction on indictment to imprisonment for a term not exceeding one year, or on summary conviction to imprisonment for a term not exceeding six months. Liability where proper accounts not kept.

(2) For the purposes of this section, proper books of account shall be deemed not to have been kept in the case of any company if there have not been kept such books or accounts as are necessary to exhibit and explain the transactions and financial position of the trade or business of the company, including books containing entries from day to day in sufficient detail of all cash received and cash paid, and, where the trade or business has involved dealings in goods, statements of the annual stocktakings and (except in the case of goods sold by way of ordinary retail trade) of all goods sold and purchased, showing the goods and the buyers and sellers thereof in sufficient detail to enable those goods and those buyers and sellers to be identified.

340.—Where a company is being wound up, all books and papers of the company and of the liquidators shall, as between the contributories of the company, be prima facie evidence of the truth of all matters purporting to be therein recorded. Books of company to be evidence.

410.—(1) Every oversea company shall, in every calendar year, make out a balance sheet and profit and loss account and, if the company is a holding company, group accounts, in such form, and containing such particulars and including such documents, as under the provisions of this Act (subject, however, to any prescribed exceptions) it would, if it had been a company within the meaning of this Act, have been required to make out and lay before the company in general meeting, and deliver copies of those documents to the registrar of companies: Accounts of oversea company.

Provided that a company registered under the law relating to companies for the time being in force in Northern Ireland and having provisions in its constitution which would, if it had been registered in Great Britain, entitle it to rank as a private company, need not comply with the foregoing provisions of this subsection if there is delivered to the registrar a certificate signed by a director and by the secretary of the company that, had section one hundred and twenty-nine of, and the Seventh Schedule to, this Act extended to Northern Ireland it would at the date of the certificate have been an exempt private company.

(2) If any such document as is mentioned in the foregoing subsection is not written in the English language, there shall be annexed to it a certified translation thereof.

PART XIII.

GENERAL

Form of Registers, &c.

Form of
registers, &c.

436.—(1) Any register, index, minute book or book of account required by this Act to be kept by a company may be kept either by making entries in bound books or by recording the matters in question in any other manner.

(2) Where any such register, index, minute book or book of account is not kept by making entries in a bound book, but by some other means, adequate precautions shall be taken for guarding against falsification and facilitating its discovery, and where default is made in complying with this subsection, the company and every officer of the company who is in default shall be liable to a fine not exceeding fifty pounds and further shall be liable to a default fine.

Power of court
to grant relief
in certain cases.

448.—(1) If in any proceeding for negligence, default, breach of duty or breach of trust against an officer of a company or a person employed by a company as auditor (whether he is or is not an officer of the company) it appears to the court hearing the case that that officer or person is or may be liable in respect of the negligence, default, breach of duty or breach of trust, but that he has acted honestly and reasonably, and that, having regard to all the circumstances of the case, including those connected with his appointment, he ought fairly to be excused for negligence, default, breach of duty or breach of trust, that court may relieve him, either wholly or partly, from his liability on such terms as the court may think fit.

(2) Where any such officer or person aforesaid has reason to apprehend that any claim will or might be made against him in respect of any negligence, default, breach of duty or breach of trust, he may apply to the court for relief, and the court on any such application shall have the same power to relieve him as under this section it would have had if it had been a court before which proceedings against that person for negligence, default, breach of duty or breach of trust had been brought.

(3) Where any case to which subsection (1) of this section applies is being tried by a judge with a jury, the judge, after hearing the evidence, may, if he is satisfied that the defendant ought in pursuance of that subsection to be relieved either in whole or in part from the liability sought to be enforced against him, withdraw the case in whole or in part from the jury and forthwith direct judgment to be entered

for the defendant on such terms as to costs or otherwise as the judge may think proper.

454.—(1) The Board of Trade shall have power by regulations made by statutory instrument to alter or add to the requirements of this Act as to the matters to be stated in a company's balance sheet, profit and loss account and group accounts, and in particular of those of the Eighth Schedule to this Act; and any reference in this Act to the said Eighth Schedule shall be construed as a reference to that Schedule with any alterations or additions made by regulations for the time being in force under this subsection.

Power to alter tables and forms.

(2) The Board of Trade may by regulations made by statutory instrument—

- (a) alter Table A, the Twelfth Schedule to this Act so that it does not increase the amount of fees payable to the registrar under that Schedule, and the form in the Thirteenth Schedule to this Act; and
- (b) alter or add to Tables B, C, D, and E in the First Schedule to this Act and the forms in the Second Schedule and Part II of the Sixth Schedule to this Act;

but no alteration made by the Board of Trade in Table A shall affect any company registered before the alteration, or repeal as respects that company any portion of that Table.

(3) No regulations shall be made under subsection (1) of this section so as to render more onerous the requirements therein referred to, unless a draft of the instrument containing the regulations has been laid before Parliament and has been approved by resolution of each House of Parliament.

(4) A statutory instrument containing regulations made under this section, not being regulations to which the last foregoing subsection applies, shall be subject to annulment in pursuance of a resolution of either House of Parliament.

458.—(1) Paragraph (d) of subsection (1) of section ten of the Companies Act, 1907, paragraph (d) of subsection (1) of section ninety-three of the Companies (Consolidation) Act, 1908, and paragraph (d) of subsection (2) of section seventy-nine of the Companies Act, 1929 (by virtue whereof charges created on land by a company required registration under those Acts respectively), shall be deemed never to have applied to a charge for any rent or other periodical sum issuing out of the land.

Effect of provisions of former Companies Acts as to registration of charges on land and keeping books of account.
7 Edw. 7. c. 50.

(2) Subsection (1) of section two hundred and seventy-four of the Companies Act, 1929 (which penalised the persons responsible where proper books of account were not kept by a company throughout the two years immediately preceding the commencement of the winding up) shall be deemed always to have had effect—

- (a) as if after the words "the period of two years immediately preceding the commencement of the winding up" there had been inserted the words "or the period between the incorporation of the company and the commencement of the winding up, whichever is the shorter"; and
- (b) as if, in the phrase "unless he shows that he acted honestly or that in the circumstances in which the business of the company was carried on the default was excusable," for the word "or" there had been substituted the word "and."

11 & 12 GEO. 6.

CH. 38.

COMPANIES ACT, 1948

Sections 56, 149,
162, 167, 454

EIGHTH SCHEDULE.

ACCOUNTS.

1. Paragraphs 2 to 11 of this Schedule apply to the balance sheet and 12 to 14 to the profit and loss account, and are subject to the exceptions and modifications provided for by Part II of this Schedule in the case of a holding company and by Part III thereof in the case of companies of the classes there mentioned; and this Schedule has effect in addition to the provisions of sections one hundred and ninety-six and one hundred and ninety-seven of this Act.

PART I.

GENERAL PROVISIONS AS TO BALANCE SHEET AND PROFIT AND LOSS ACCOUNT.

Balance Sheet.

2. The authorised share capital, issued share capital, liabilities and assets shall be summarised, with such particulars as are necessary to disclose the general nature of the assets and liabilities, and there shall be specified—

- (a) any part of the issued capital that consists of redeemable preference shares, and the earliest date on which the company has power to redeem those shares;
- (b) so far as the information is not given in the profit and loss account, any share capital on which interest has been paid out of capital during the financial year, and the rate at which interest has been so paid;
- (c) the amount of the share premium account;
- (d) particulars of any redeemed debentures which the company has power to re-issue.

3. There shall be stated under separate headings, so far as they are not written off,—

- (a) the preliminary expenses;
- (b) any expenses incurred in connection with any issue of share capital or debentures;
- (c) any sums paid by way of commission in respect of any shares or debentures;
- (d) any sums allowed by way of discount in respect of any debentures; and
- (e) the amount of the discount allowed on any issue of shares at a discount.

4.—(1) The reserves, provisions, liabilities and fixed and current assets shall be classified under headings appropriate to the company's business:

Provided that—

- (a) where the amount of any class is not material, it may be included under the same heading as some other class; and
- (b) where any assets of one class are not separable from assets of another class, those assets may be included under the same heading.

(2) Fixed assets shall also be distinguished from current assets.

(3) The method or methods used to arrive at the amount of the fixed assets under each heading shall be stated.

5.—(1) The method of arriving at the amount of any fixed asset shall, subject to the next following sub-paragraph, be to take the difference between—

- (a) its cost or, if it stands in the company's books at a valuation, the amount of the valuation; and
- (b) the aggregate amount provided or written off since the date of acquisition or valuation, as the case may be, for depreciation or diminution in value;

and for the purposes of this paragraph the net amount at which any assets stand in the company's books at the date of the coming into force of this Act (after deduction of the amounts previously provided or written off for depreciation or diminution in value) shall if the figures relating to the period before the commencement of this Act cannot be obtained without unreasonable expense or delay, be treated as if it were the amount of a valuation of those assets made at the commencement of this Act and, where any of those assets are sold, the said net amount less the amount of the sales shall be treated as if it were the amount of a valuation so made of the remaining assets.

(2) The foregoing sub-paragraph shall not apply—

- (a) to assets for which the figures relating to the period beginning with the commencement of this Act cannot be obtained without unreasonable expense or delay; or
- (b) to assets the replacement of which is provided for wholly or partly—
 - (i) by making provision for renewals and charging the cost of replacement against the provision so made; or
 - (ii) by charging the cost of replacement direct to revenue;or
- (c) to any investments of which the market value (or, in the case of investments not having a market value, their value as estimated by the directors) is shown either as the amount of the investments or by way of note; or
- (d) to goodwill, patents or trade marks.

(3) For the assets under each heading whose amount is arrived at in accordance with sub-paragraph (1) of this paragraph, there shall be shown—

- (a) the aggregate of the amounts referred to in paragraph (a) of that sub-paragraph; and
- (b) the aggregate of the amounts referred to in paragraph (b) thereof.

8TH SCH.—*cont.*

(4) As respects the assets under each heading whose amount is not arrived at in accordance with the said sub-paragraph (1) because their replacement is provided for as mentioned in sub-paragraph (2) (b) of this paragraph, there shall be stated—

- (a) the means by which their replacement is provided for; and
- (b) the aggregate amount of the provision (if any) made for renewals and not used.

6. The aggregate amounts respectively of capital reserves, revenue reserves and provisions (other than provisions for depreciation, renewals or diminution in value of assets) shall be stated under separate headings:

Provided that—

- (a) this paragraph shall not require a separate statement of any of the said three amounts which is not material; and
- (b) the Board of Trade may direct that it shall not require a separate statement of the amount of provisions where they are satisfied that that is not required in the public interest and would prejudice the company, but subject to the condition that any heading stating an amount arrived at after taking into account a provision (other than as aforesaid) shall be so framed or marked as to indicate that fact.

7.—(1) There shall also be shown (unless it is shown in the profit and loss account or a statement or report annexed thereto, or the amount involved is not material)—

- (a) where the amount of the capital reserves, of the revenue reserves or of the provisions (other than provisions for depreciation, renewals or diminution in value of assets) shows an increase as compared with the amount at the end of the immediately preceding financial year, the source from which the amount of the increase has been derived; and

(b) where—

(i) the amount of the capital reserves or of the revenue reserves shows a decrease as compared with the amount at the end of the immediately preceding financial year; or

(ii) the amount at the end of the immediately preceding financial year of the provisions (other than provisions for depreciation, renewals or diminution in value of assets) exceeded the aggregate of the sums since applied and amounts still retained for the purposes thereof;

the application of the amounts derived from the difference.

(2) Where the heading showing any of the reserves or provisions aforesaid is divided into sub-headings, this paragraph shall apply to each of the separate amounts shown in the sub-headings instead of applying to the aggregate amount thereof.

8.—(1) There shall be shown under separate headings—

- (a) the aggregate amounts respectively of the company's trade investments, quoted investments other than trade investments and unquoted investments other than trade investments;
- (b) if the amount of the goodwill and of any patents and trade-marks or part of that amount is shown as a separate item in or is otherwise ascertainable from the books of the

company, or from any contract for the sale or purchase of any property to be acquired by the company, or from any documents in the possession of the company relating to the stamp duty payable in respect of any such contract or the conveyance of any such property, the said amount so shown or ascertained so far as not written off or, as the case may be, the said amount so far as it is so shown or ascertainable and as so shown or ascertained, as the case may be;

- (c) the aggregate amount of any outstanding loans made under the authority of provisos (b) and (c) of subsection (1) of section fifty-four of this Act;
- (d) the aggregate amount of bank loans and overdrafts;
- (e) the net aggregate amount (after deduction of income tax) which is recommended for distribution by way of dividend.

(2) Nothing in head (b) of the foregoing sub-paragraph shall be taken as requiring the amount of the goodwill, patents and trademarks to be stated otherwise than as a single item.

(3) The heading showing the amount of the quoted investments other than trade investments shall be sub-divided, where necessary, to distinguish the investments as respects which there has, and those as respects which there has not, been granted a quotation or permission to deal on a recognised stock exchange.

9. Where any liability of the company is secured otherwise than by operation of law on any assets of the company, the fact that that liability is so secured shall be stated, but it shall not be necessary to specify the assets on which the liability is secured.

10. Where any of the company's debentures are held by a nominee or trustee for the company, the nominal amount of the debentures and the amount at which they are stated in the books of the company shall be stated.

11.—(1) The matters referred to in the following sub-paragraphs shall be stated by way of note, or in a statement or report annexed, if not otherwise shown.

(2) The number, description and amount of any shares in the company which any person has an option to subscribe for, together with the following particulars of the option, that is to say—

- (a) the period during which it is exercisable;
- (b) the price to be paid for shares subscribed for under it.

(3) The amount of any arrears of fixed cumulative dividends on the company's shares and the period for which the dividends or, if there is more than one class, each class of them are in arrear, the amount to be stated before deduction of income tax, except that, in the case of tax free dividends, the amount shall be shown free of tax and the fact that it is so shown shall also be stated.

(4) Particulars of any charge on the assets of the company to secure the liabilities of any other person, including, where practicable, the amount secured.

(5) The general nature of any other contingent liabilities not provided for and, where practicable, the aggregate amount or estimated amount of those liabilities, if it is material.

8TH SCH.—*cont.*

(6) Where practicable the aggregate amount or estimated amount, if it is material, of contracts for capital expenditure, so far as not provided for.

(7) If in the opinion of the directors any of the current assets have not a value, on realisation in the ordinary course of the company's business, at least equal to the amount at which they are stated, the fact that the directors are of that opinion.

(8) The aggregate market value of the company's quoted investments, other than trade investments, where it differs from the amount of the investments as stated, and the stock exchange value of any investments of which the market value is shown (whether separately or not) and is taken as being higher than their stock exchange value.

(9) The basis on which foreign currencies have been converted into sterling, where the amount of the assets or liabilities affected is material.

(10) The basis on which the amount, if any, set aside for United Kingdom income tax is computed.

(11) Except in the case of the first balance sheet laid before the company after the commencement of this Act, the corresponding amounts at the end of the immediately preceding financial year for all items shown in the balance sheet.

Profit and Loss Account.

12.—(1) There shall be shown—

- (a) the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets;
- (b) the amount of the interest on the company's debentures and other fixed loans;
- (c) the amount of the charge for United Kingdom income tax and other United Kingdom taxation on profits, including, where practicable, as United Kingdom income tax any taxation imposed elsewhere to the extent of the relief, if any, from United Kingdom income tax and distinguishing where practicable between income tax and other taxation;
- (d) the amounts respectively provided for redemption of share capital and for redemption of loans;
- (e) the amount, if material, set aside or proposed to be set aside to, or withdrawn from, reserves;
- (f) subject to sub-paragraph (2) of this paragraph, the amount, if material, set aside to provisions other than provisions for depreciation, renewals or diminution in value of assets or, as the case may be, the amount, if material, withdrawn from such provisions and not applied for the purposes thereof;
- (g) the amount of income from investments, distinguishing between trade investments and other investments;
- (h) the aggregate amount of the dividends paid and proposed.

(2) The Board of Trade may direct that a company shall not be obliged to show an amount set aside to provisions in accordance with sub-paragraph (1) (f) of this paragraph, if the Board is satisfied that that is not required in the public interest and would prejudice the

company, but subject to the condition that any heading stating an amount arrived at after taking into account the amount set aside as aforesaid shall be so framed or marked as to indicate that fact. 8TH SCH.—cont.

13. If the remuneration of the auditors is not fixed by the company in general meeting, the amount thereof shall be shown under a separate heading, and for the purposes of this paragraph, any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration."

14.—(1) The matters referred to in the following sub-paragraphs shall be stated by way of note, if not otherwise shown.

(2) If depreciation or replacement of fixed assets is provided for by some method other than a depreciation charge or provision for renewals, or is not provided for, the method by which it is provided for or the fact that it is not provided for, as the case may be.

(3) The basis on which the charge for United Kingdom income tax is computed.

(4) Whether or not the amount stated for dividends paid and proposed is for dividends subject to deduction of income tax.

(5) Except in the case of the first profit and loss account laid before the company after the commencement of this Act, the corresponding amounts for the immediately preceding financial year for all items shown in the profit and loss account.

(6) Any material respects in which any items shown in the profit and loss account are affected—

(a) by transactions of a sort not usually undertaken by the company or otherwise by circumstances of an exceptional or non-recurrent nature; or

(b) by any change in the basis of accounting.

PART II.

SPECIAL PROVISIONS WHERE THE COMPANY IS A HOLDING OR SUBSIDIARY COMPANY.

Modifications of and Additions to Requirements as to Company's own Accounts.

15.—(1) This paragraph shall apply where the company is a holding company, whether or not it is itself a subsidiary of another body corporate.

(2) The aggregate amount of assets consisting of shares in, or amounts owing (whether on account of a loan or otherwise) from, the company's subsidiaries, distinguishing shares from indebtedness, shall be set out in the balance sheet separately from all the other assets of the company, and the aggregate amount of indebtedness (whether on account of a loan or otherwise) to the company's subsidiaries shall be so set out separately from all its other liabilities and—

8TH SCH.—*cont.*

- (a) the references in Part I of this Schedule to the company's investments shall not include investments in its subsidiaries required by this paragraph to be separately set out; and
- (b) paragraph 5, sub-paragraph (1) (a) of paragraph 12, and sub-paragraph (2) of paragraph 14 of this Schedule shall not apply in relation to fixed assets consisting of interests in the company's subsidiaries.

(3) There shall be shown by way of note on the balance sheet or in a statement or report annexed thereto the number, description and amount of the shares in and debentures of the company held by its subsidiaries or their nominees, but excluding any of those shares or debentures in the case of which the subsidiary is concerned as personal representative or in the case of which it is concerned as trustee and neither the company nor any subsidiary thereof is beneficially interested under the trust, otherwise than by way of security only for the purposes of a transaction entered into by it in the ordinary course of a business which includes the lending of money.

(4) Where group accounts are not submitted, there shall be annexed to the balance sheet a statement showing—

- (a) the reasons why subsidiaries are not dealt with in group accounts;
- (b) the net aggregate amount, so far as it concerns members of the holding company and is not dealt with in the company's accounts, of the subsidiaries' profits after deducting the subsidiaries' losses (or vice versa)—
 - (i) for the respective financial years of the subsidiaries ending with or during the financial year of the company; and
 - (ii) for their previous financial years since they respectively became the holding company's subsidiary;
- (c) the net aggregate amount of the subsidiaries' profits after deducting the subsidiaries' losses (or vice versa)—
 - (i) for the respective financial years of the subsidiaries ending with or during the financial year of the company; and
 - (ii) for their other financial years since they respectively became the holding company's subsidiary;
 so far as those profits are dealt with, or provision is made for those losses, in the company's accounts;
- (d) any qualifications contained in the report of the auditors of the subsidiaries on their accounts for their respective financial years ending as aforesaid, and any note or saving contained in those accounts to call attention to a matter which, apart from the note or saving, would properly have been referred to in such a qualification, in so far as the matter which is the subject of the qualification or note is not covered by the company's own accounts and is material from the point of view of its members;

or, in so far as the information required by this sub-paragraph is not obtainable, a statement that it is not obtainable:

Provided that the Board of Trade may, on the application or with the consent of the company's directors, direct that in relation to any

subsidiary this sub-paragraph shall not apply or shall apply only to 8TH SCH.—cont. such extent as may be provided by the direction.

(5) Paragraphs (b) and (c) of the last foregoing sub-paragraph shall apply only to profits and losses of a subsidiary which may properly be treated in the holding company's accounts as revenue profits or losses, and the profits or losses attributable to any shares in a subsidiary for the time being held by the holding company or any other of its subsidiaries shall not (for that or any other purpose) be treated as aforesaid so far as they are profits or losses for the period before the date on or as from which the shares were acquired by the company or any of its subsidiaries, except that they may in a proper case be so treated where—

- (a) the company is itself the subsidiary of another body corporate; and
- (b) the shares were acquired from that body corporate or a subsidiary of it;

and for the purpose of determining whether any profits or losses are to be treated as profits or losses for the said period the profit or loss for any financial year of the subsidiary may, if it is not practicable to apportion it with reasonable accuracy by reference to the facts, be treated as accruing from day to day during that year and be apportioned accordingly.

(6) Where group accounts are not submitted, there shall be annexed to the balance sheet a statement showing, in relation to the subsidiaries (if any) whose financial years did not end with that of the company—

- (a) the reasons why the company's directors consider that the subsidiaries' financial years should not end with that of the company; and
- (b) the dates on which the subsidiaries' financial years ending last before that of the company respectively ended or the earliest and latest of those dates.

16.—(1) The balance sheet of a company which is a subsidiary of another body corporate, whether or not it is itself a holding company, shall show the aggregate amount of its indebtedness to all bodies corporate of which it is a subsidiary or a fellow subsidiary and the aggregate amount of the indebtedness of all such bodies corporate to it, distinguishing in each case between indebtedness in respect of debentures and otherwise.

(2) For the purposes of this paragraph a company shall be deemed to be a fellow subsidiary of another body corporate if both are subsidiaries of the same body corporate but neither is the other's.

Consolidated Accounts of Holding Company and Subsidiaries.

17. Subject to the following paragraphs of this Part of this Schedule, the consolidated balance sheet and profit and loss account shall combine the information contained in the separate balance sheets and profit and loss accounts of the holding company and of the subsidiaries dealt with by the consolidated accounts, but with such adjustments (if any) as the directors of the holding company think necessary.

18. Subject as aforesaid and to Part III of this Schedule, the consolidated accounts shall, in giving the said information, comply, so

8TH SCH.—*cont.* far as practicable, with the requirements of this Act as if they were the accounts of an actual company.

19. Sections one hundred and ninety-six and one hundred and ninety-seven of this Act shall not, by virtue of the two last foregoing paragraphs, apply for the purpose of the consolidated accounts.

20. Paragraph 7 of this Schedule shall not apply for the purpose of any consolidated accounts laid before a company with the first balance sheet so laid after the commencement of this Act.

21. In relation to any subsidiaries of the holding company not dealt with by the consolidated accounts—

- (a) sub-paragraphs (2) and (3) of paragraph 15 of this Schedule shall apply for the purpose of those accounts as if those accounts were the accounts of an actual company of which they were subsidiaries; and
- (b) there shall be annexed the like statement as is required by sub-paragraph (4) of that paragraph where there are no group accounts, but as if references therein to the holding company's accounts were references to the consolidated accounts.

22. In relation to any subsidiaries (whether or not dealt with by the consolidated accounts), whose financial years did not end with that of the company, there shall be annexed the like statement as is required by sub-paragraph (6) of paragraph 15 of this Schedule where there are no group accounts.

PART III.

EXCEPTIONS FOR SPECIAL CLASSES OF COMPANY.

23.—(1) A banking or discount company shall not be subject to the requirements of Part I of this Schedule other than—

- (a) as respects its balance sheet, those of paragraphs 2 and 3, paragraph 4 (so far as it relates to fixed and current assets), paragraph 8 (except sub-paragraph (1) (d), paragraphs 9 and 10, and paragraph 11 (except sub-paragraph (8)); and
- (b) as respects its profit and loss account, those of sub-paragraph (1) (h) of paragraph 12, paragraph 13 and sub-paragraphs (1), (4) and (5) of paragraph 14;

but, where in its balance sheet capital reserves, revenue reserves or provisions (other than provisions for depreciation, renewals or diminution in value of assets) are not stated separately, any heading stating an amount arrived at after taking into account such a reserve or provision shall be so framed or marked as to indicate that fact, and its profit and loss account shall indicate by appropriate words the manner in which the amount stated for the company's profit or loss has been arrived at.

(2) The accounts of a banking or discount company shall not be deemed, by reason only of the fact that they do not comply with any requirements of the said Part I from which the company is exempt by virtue of this paragraph, not to give the true and fair view required by this Act.

(3) In this paragraph the expression "banking or discount company" means any company which satisfies the Board of Trade that it ought to be treated for the purposes of this Schedule as a banking company or as a discount company. 8TH SCH.—cont.

24.—(1) In relation to an assurance company within the meaning of the Assurance Companies Acts, 1909 to 1946, which is subject to and complies with the requirements of those Acts as respects the preparation and deposit with the Board of Trade of a balance sheet and profit and loss account, the foregoing paragraph shall apply as it applies in relation to a banking or discount company, and such an assurance company shall also not be subject to the requirements of sub-paragraphs (1) (a) and (3) of paragraph 8 and sub-paragraphs (4) to (7) and sub-paragraph (10) of paragraph 11 of this Schedule:

Provided that the Board of Trade may direct that any such assurance company whose business includes to a substantial extent business other than assurance business shall comply with all the requirements of the said Part I or such of them as may be specified in the direction and shall comply therewith as respects either the whole of its business or such part thereof as may be so specified.

(2) Where an assurance company is entitled to the benefit of this paragraph, then any wholly owned subsidiary thereof shall also be so entitled if its business consists only of business which is complementary to assurance business of the classes carried on by the assurance company.

(3) For the purposes of this paragraph a company shall be deemed to be the wholly owned subsidiary of an assurance company if it has no members except the assurance company and the assurance company's wholly owned subsidiaries and its or their nominees.

25.—(1) A company to which this paragraph applies shall not be subject to the following requirements of this Schedule, that is to say—

- (a) as respects its balance sheet, those of paragraph 4 (except so far as the said paragraph relates to fixed and current assets) and paragraphs 5, 6 and 7; and
- (b) as respects its profit and loss account, those of sub-paragraph (1) (a), (e) and (f) of paragraph 12;

but a company taking advantage of this paragraph shall be subject, instead of the said requirements, to any prescribed conditions as respects matters to be stated in its accounts or by way of note thereto and as respects information to be furnished to the Board of Trade or a person authorised by them to require it.

(2) The accounts of a company shall not be deemed, by reason only of the fact that they do not comply with any requirements of Part I of this Schedule from which the company is exempt by virtue of this paragraph, not to give the true and fair view required by this Act.

(3) This paragraph applies to companies of any class prescribed for the purposes thereof, and a class of companies may be so prescribed if it appears to the Board of Trade desirable in the national interest:

Provided that, if the Board of Trade are satisfied that any of the conditions prescribed for the purposes of this paragraph has not been complied with in the case of any company, they may direct that so long as the direction continues in force this paragraph shall not apply to the company.

8TH SCH.—*cont.*

26. Where a company entitled to the benefit of any provision contained in this Part of this Schedule is a holding company, the reference in Part II of this Schedule to consolidated accounts complying with the requirements this Act shall, in relation to consolidated accounts of that company, be construed as referring to those requirements in so far only as they apply to the separate accounts of that company.

PART IV.

INTERPRETATION OF SCHEDULE.

27.—(1) For the purposes of this Schedule, unless the context otherwise requires,—

- (a) the expression “provision” shall, subject to sub-paragraph (2) of this paragraph, mean any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy;
- (b) the expression “reserve” shall not, subject as aforesaid, include any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability;
- (c) the expression “capital reserve” shall not include any amount regarded as free for distribution through the profit and loss account and the expression “revenue reserve” shall mean any reserve other than a capital reserve;

and in this paragraph the expression “liability” shall include all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

(2) Where—

- (a) any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets, not being an amount written off in relation to fixed assets before the commencement of this Act; or
- (b) any amount retained by way of providing for any known liability;

is in excess of that which in the opinion of the directors is reasonably necessary for the purpose, the excess shall be treated for the purposes of this Schedule as a reserve and not as a provision.

28. For the purposes aforesaid, the expression “quoted investment” means an investment as respects which there has been granted a quotation or permission to deal on a recognised stock exchange, or on any stock exchange of repute outside Great Britain, and the expression “unquoted investment” shall be construed accordingly.

NINTH SCHEDULE

Section 169.

MATTERS TO BE EXPRESSLY STATED IN AUDITORS' REPORT.

1. Whether they have obtained all the information and explanations which to the best of their knowledge and belief were necessary for the purposes of their audit.

2. Whether, in their opinion, proper books of account have been kept by the company, so far as appears from their examination of those books, and proper returns adequate for the purposes of their audit have been received from branches not visited by them.

3.—(1) Whether the company's balance sheet and (unless it is framed as a consolidated profit and loss account) profit and loss account dealt with by the report are in agreement with the books of account and returns.

(2) Whether, in their opinion and to the best of their information and according to the explanations given them, the said accounts give the information required by this Act in the manner so required and give a true and fair view—

(a) in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year; and

(b) in the case of the profit and loss account, of the profit or loss for its financial year;

or, as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act are not required to be disclosed.

4. In the case of a holding company submitting group accounts whether, in their opinion, the group accounts have been properly prepared in accordance with the provisions of this Act so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries dealt with thereby, so far as concerns members of the company, or, as the case may be, so as to give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act are not required to be disclosed.

APPENDIX B

PUBLISHED ACCOUNTS OF COMPANIES

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MORRIS MOTORS, LIMITED

1949			
£	£		£
5,850,000		I. AUTHORISED AND ISSUED CAPITAL:—	5,850,000
		3,000,000 7½ per cent. Cumulative Preference Stock Units of £1 each, fully paid	3,000,000
		10,800,000 Ordinary Stock Units of 5s. each, fully paid	2,850,000
			<u>£5,850,000</u>
342,805		II. CAPITAL RESERVES:—	427,378
310,351		(a) Profits prior to Incorporation	310,351
32,454		(b) Profits on Sales of Fixed Assets and Sundry Surpluses Including £75,024 surpluses realised in 1950	117,027
			<u>£427,378</u>
5,270,579		III. REVENUE RESERVES AND SURPLUS:—	8,837,223
3,826,836		(a) General Reserve Accounts (After giving effect to Proposed Appropriation)	5,734,408
400,000		(b) Dividend Equilisation Reserve Account	400,000
478,232		(c) Reserve for Future Income Tax Including one-fourth of estimated liability for 1950/51	1,999,280
89,853		(d) Taxation Adjustment Reserve	150,000
525,658		(e) Revenue Account (After giving effect to Proposed Appropriations)	553,585
			<u>£8,837,223</u>
1,321,390		IV. PROVISIONS:—	1,390,037
982,751		(a) Rehabilitation, Deferred Repairs, and Taxation in Suspense	987,006
338,639		(b) Sundry Provisions	403,031
			<u>£1,390,037</u>
5,797,247		V. CURRENT LIABILITIES:—	6,663,100
4,504,364		(a) Sundry Creditors and Accrued Charges	4,767,348
11,065		(b) Employees' Provident and Savings Clubs	9,087
155,618		(c) Income Tax, including balance of estimated liability for 1950/51	132,743
741,950		(d) Profits Tax	1,803,474
394,350		(e) Proposed Distribution on Ordinary Stock Final Dividend—Net Amount Payable	450,500
			<u>£6,663,100</u>

NOTES:—

- There are Contingent Liabilities under guarantees given on behalf of a Subsidiary Company, viz:—
Acceptance Credits £3,883,623
Bills Receivable sold £100,000.
- Owing to war damage, adjustments will require to be made in respect of certain assets.
- Cost investigations by Government Departments and Principal Contractors have not been wholly completed, and amounts due have been estimated.

NUFFIELD, Chairman.

R. F. HANKS, Vice-Chairman.

W. HOBBS, Secretary.

£18,383,021£22,867,738

Balance Sheet as at 31st December, 1950

1949					
£	£	Cost 1-1-50	Additions (less Disposals)	Accumulated Depreciation	Book Value 31-12-50
1,432,780		2,085,401	129,773	633,189	1,582,004
354,458		889,760	Cr. 192,596	28,587	168,567
1,548,942		4,370,102	1,180,533	3,006,341	2,444,294
3,331,180		£6,745,253	£1,117,709	£3,668,097	4,194,865
<i>Assets acquired from 1st January, 1948, from Subsidiary Companies at net book values have been grossed up in the above figures to give the original cost to the Subsidiaries concerned and the accumulated depreciation provided by them.</i>					
948,483		(d) Capital Commitments, and Payments on account of Buildings and Equipment under construction			1,509,311
1		(e) Goodwill, Patent Rights and Trade Marks			1
		At Cost, less Amounts written off			
4,329,669					5,704,077
2,395,034					2,345,034
	200,053	II. INVESTMENTS AT COST:—		1,109,263	
		(a) Subsidiary Companies:—			
	50,000	(1) Morris Commercial Cars, Limited	200,053		
	320,000	200,053 Shares of £1 each, fully paid			
	100,000	(2) Nuffield Acceptances, Limited (In Voluntary Liquidation)			
	110,000	50,000 Shares of £1 each, fully paid			
	50,000	(3) Nuffield (Australia) Pty., Limited	320,000		
	100	400,000 Shares of £1 each, fully paid			
	100	(4) Nuffield Exports, Limited	100,000		
	19,000	100,000 Shares of £1 each, fully paid			
	10,000	(5) Nuffield Mechanisations, Limited	110,000		
	50,000	110,000 Shares of £1 each, fully paid			
	250,000	(6) Nuffield Metal Products, Limited	50,000		
	1,159,253	50,000 Shares of £1 each, fully paid			
	4,727	(7) Nuffield Tools and Gauges, Limited	100		
	38,600	100 Shares of £1 each, fully paid			
	1,092,454	(8) Riley Motors, Limited	100		
	£2,395,034	143,119 Shares of £1 each, fully paid			
	11,757,318	(9) The M.G. Car Company, Limited	19,000		
		19,000 Shares of £1 each, fully paid			
		(10) The Nuffield Press, Limited	10,000		
		10,000 Shares of £1 each, fully paid			
		(11) The S.U. Carburettor Company, Limited	50,000		
		50,000 Shares of £1 each, fully paid			
		(12) Wolseley Motors, Limited	250,000		
		250,000 Shares of £1 each, fully paid			
			£1,109,263		
		(b) British Government Stock		4,727	
		(Market Value £4,768)			
		(c) Dominion Government Stock		38,600	
		(Market Value £38,691)			
		(d) United Kingdom Corporation Stocks		1,092,454	
		(Market Value £1,119,417)			
				£2,345,034	
		III. CURRENT ASSETS:—			14,918,637
		(a) Subsidiary Companies:—			
	4,099,056	(1) Net Amount due on Dividend, Current and Advance Accounts after adjusting Unrealised Profit of Inter-Company Sales		5,563,425	
		Receivable	6,994,181		
		Payable	1,360,756		
			£5,563,425		
		(2) Net Amount receivable from Liquidator of Nuffield Acceptances, Limited		9,781	
	589,189	(b) Sundry Debtors, including Bills Receivable, Interest accrued on Investments, and Prepayments		754,443	
	6,794,239	Less Provision for Doubtful Debts			
	274,834	(c) Stock, including Work in Progress and Tools As certified by Officials of the Company		7,829,155	
	£11,757,318	(d) Cash at Bank, in Hand and in Transit		1,261,823	
				£14,918,637	
£18,388,021					£22,867,788

MORRIS MOTORS, LIMITED

Consolidated Balance Sheet

as at 31st December, 1950

1949			
£		£	£
5,680,000	I. AUTHORISED AND ISSUED CAPITAL:—		5,680,000
	3,000,000 7½ per cent. Cumulative Preference Stock Units of £1 each, fully paid	3,000,000	
	10,800,000 Ordinary Stock Units of 5s. each, fully paid	2,680,000	
		<u>£5,680,000</u>	
2,319,880	II. CAPITAL RESERVES:—		2,412,139
310,351	(a) Profits prior to Incorporation of Morris Motors, Limited ..	310,351	
1,814,643	(b) Surpluses of Subsidiary Companies at the dates of acquisition by Morris Motors, Limited	1,814,643	
194,866	(c) Profits on Sales of Fixed Assets and Sundry Surpluses ..	287,145	
	Including £82,730 surpluses realised in 1950		
<u>£2,319,880</u>		<u>£2,412,139</u>	
5,946,824	III. REVENUE RESERVES AND SURPLUS:—		10,840,868
3,887,267	(a) General Reserve Accounts	6,000,000	
	(After giving effect to Proposed Appropriation)		
400,000	(b) Dividend Equalisation Reserve Account	400,000	
1,094,046	(c) Reserve for Future Income Tax	3,287,088	
	Including one-fourth of estimated liability for 1950/51		
39,853	(d) Taxation Adjustment Reserve	150,000	
525,658	(e) Revenue Account	553,535	
	(After giving effect to Proposed Appropriations)		
<u>£5,946,824</u>		<u>£10,840,868</u>	
1,597,758	IV. PROVISIONS:—		1,959,938
1,077,467	(a) Rehabilitation, Deferred Repairs and Taxation in Suspense ..	931,044	
520,291	(b) Sundry Provisions	1,028,894	
<u>£1,597,758</u>		<u>£1,959,938</u>	
10,267,331	V. CURRENT LIABILITIES:—		14,655,632
8,708,214	(a) Sundry Creditors and Accrued Charges	9,423,116	
—	(b) Acceptance Credits	3,384,741	
12,547	(c) Employees' Provident and Savings Clubs	10,592	
401,545	(d) Income Tax, including balance of estimated liability for 1950/51	81,198	
750,775	(e) Profits Tax	1,305,555	
384,280	(f) Proposed Distribution on Ordinary Stock	450,500	
	Final Dividend—Net Amount Payable		
<u>£10,267,331</u>		<u>£14,655,632</u>	

NUFFIELD, Chairman.

R. F. HANKS, Vice-Chairman.

£25,771,773£25,018,377

MORRIS MOTORS, LIMITED
 MORRIS COMMERCIAL CARS, LIMITED
 NUFFIELD ACCEPTANCES, LIMITED (IN VOLUNTARY
 LIQUIDATION)
 NUFFIELD (AUSTRALIA) PTY., LIMITED
 NUFFIELD EXPORTS, LIMITED
 NUFFIELD MECHANISATIONS, LIMITED

NUFFIELD METAL PRODUCTS, LIMITED
 NUFFIELD TOOLS AND GAUGES, LIMITED
 RILEY MOTORS, LIMITED
 THE M.G. CAR COMPANY, LIMITED
 THE NUFFIELD PRESS, LIMITED
 THE S.U. CARBURETTOR COMPANY, LIMITED
 WOLSKLEY MOTORS, LIMITED

1949							
£	£			* Cost 1-1-50	Additions (less Disposals)	Accumulated Depreciation	Book Value 31-12-50
I. FIXED ASSETS:—							
2,569,912		(a)	Freehold Land and Buildings ..	3,462,527	344,818	945,711	2,861,634
365,348		(b)	Leasehold Land and Buildings	402,380	Cr. 191,936	30,578	179,878
3,456,998		(c)	Plant, Machinery and Equipment	8,731,849	1,390,716	5,740,533	4,381,532
6,392,258				£12,596,256	£1,548,608	£6,716,820	7,428,044
* In the case of one Subsidiary Company this includes the value of the Fixed Assets per the Vendors' books at the date of acquisition in 1928 for an inclusive price, to the extent of such assets still owned.							
1,458,747		(d)	Capital Commitments, and Payments on account of Buildings and Equipment under construction				1,755,945
1		(e)	Goodwill, Patent Rights and Trade Marks:—				1
			Cost			1,642,479	
			Less Amounts written off			1,642,478	
						£1	
7,851,006							9,178,990
1,136,481		II.	INVESTMENTS AT COST:—				1,136,481
	5,427	(a)	British Government Stock (Market Value £6,466)			5,427	
	38,800	(b)	Dominion Government Stock (Market Value £38,801)			38,800	
	1,092,454	(c)	United Kingdom Corporation Stocks (Market Value £1,119,417)			1,092,454	
	£1,136,481						£1,136,481
16,784,286		III.	CURRENT ASSETS:—				24,702,906
2,592,925		(a)	Sundry Debtors, including Bills Receivable, Interest accrued on Investments, and Prepayments Less Provision for Doubtful Debts			4,806,132	
13,844,171		(b)	Stock, including Work in Progress and Tools As certified by Officials of the respective Companies			16,400,675	
556,190		(c)	Cash at Bank, in Hand and in Transit			3,496,099	
£16,784,286							£24,702,906

NOTES:—

- £1 Australian has been converted at 16s. Sterling.
- Owing to war damage, adjustments will require to be made in respect of certain assets.
- Cost investigations by Government Departments and Principal Contractors have not been wholly completed, and amounts due have been estimated.
- There is a Contingent Liability of £8,535 in respect of Bills Receivable discounted.
- There is a Contingent Liability of £100,000 in respect of Bills Receivable sold.
- Current Assets include Bills Receivable £877,901 and Cash and Bank Balances £426,803 which, together with Bills of Exchange £2,350,004 between two Subsidiary Companies, have been deposited as collateral security against Acceptance Credits.

£26,771,778

£26,018,577

MORRIS MOTORS, LIMITED

Dr.

1949			
£			£
581,386	I. To MAINTENANCE OF FIXED ASSETS		717,952
539,962	II. " PROVISION FOR DEPRECIATION AND OBSOLESCENCE OF PLANT, MACHINERY AND EQUIPMENT		619,146
54,937	III. " PROVISION FOR DEPRECIATION AND OBSOLESCENCE OF FREEHOLD BUILDINGS AND AMORTISATION OF LEASEHOLD PROPERTIES		57,978
490,178	IV. " WELFARE OF EMPLOYEES		560,751
	Including Holiday Pay, Staff Pension Fund, Provident and Savings Clubs, Gratuities, Expenses of Medical Centres, Canteens, etc., and Sundry Welfare Expenses		
10,249	V. " AUDITORS' REMUNERATION AND EXPENSES:—		11,404
		£	
	Morris Motors, Limited	5,375	
	Subsidiary Companies	5,529	
		<u>£11,404</u>	
372,635	VI. " AMOUNTS SET ASIDE TO SUNDRY PROVISIONS		781,863
2,631,426	VII. " NET EARNINGS		7,186,038
	Carried to Revenue Account		
<u>£4,680,873</u>			<u>£9,885,139</u>

Dr.

MORRIS MOTORS, LIMITED

1949	1950		
£	31st December	£	£
1,587,926	I. To TAXATION:—		4,108,270
	Estimated Profits Tax, based on Net Earnings of the year	1,080,000	
	Estimated Income Tax, based on Net Earnings of the year	3,010,000	
		<u>4,100,000</u>	
	Other Taxation, including Adjustments for previous years	116,486	
		<u>4,216,486</u>	
	Dominion Taxation, after crediting Double Taxation Relief	Cr. 108,196	
		<u>£4,108,270</u>	
39,863	II. " AMOUNT SET ASIDE TO TAXATION ADJUSTMENT RESERVE IN RESPECT OF INITIAL ALLOWANCES		110,147
5,296	III. " AMOUNTS SET ASIDE TO GENERAL RESERVE ACCOUNTS, INCLUDING £205,092 AUSTRALIAN EARNINGS UP TO 31st DECEMBER, 1949, FORMERLY WITHHELD AS REFUNDABLE UNDER PRICE CONTROL REGULATIONS		205,778
—	IV. " AMOUNT SET ASIDE TO CAPITAL RESERVE ACCOUNT, BEING NET EARNINGS IN 1950 OF NUFFIELD ACCEPTANCES, LIMITED (IN VOLUNTARY LIQUIDATION)		9,549
1,033,917	V. " BALANCE		2,774,137
<u>£2,666,992</u>	Carried down		<u>£7,207,876</u>
	1950		
	30th September		
123,750	VI. To DIVIDEND ON PREFERENCE STOCK FOR YEAR TO 30th SEPTEMBER, 1950, of 7½% LESS TAX		123,750
	Net Amount Paid		
	16th October		
265,000	VII. To INTERIM DIVIDEND ON ORDINARY STOCK OF 10% FREE OF INCOME TAX DECLARED THIS DATE		265,000
	Net Amount Paid		
	1951		
	22nd June		
	VIII. To Recommendations of the Board of Directors to be submitted for confirmation to the Annual General Meeting of the Members to be held on this date:—		
364,250	Final Dividend of 17% on Ordinary Stock free of Income Tax—Net Amount Payable		450,500
—	Transfer to General Reserve Account		1,906,960
525,658	Balance carried to Balance Sheet		553,586
<u>£1,298,658</u>			<u>£3,299,795</u>

Consolidated Profit and Loss Account for the year ended 31st Dec. 1950 Cr.

1949		
£		£
4,007,146	I. BY GROSS EARNINGS	9,886,486
49,859	II. " INTEREST ON INVESTMENTS (GROSS)	84,649
4,080	III. " INTEREST ON BANK BALANCES	11,685
848	IV. " TRANSFER FEES	869

NOTES:—

1. Directors' Emoluments.
 - (a) No fees are payable in respect of services as Directors.
 - (b) Other emoluments paid to Directors of Morris Motors, Limited, and its Subsidiary Companies (including Staff Pension Fund Contributions) amounted to £55,427 for the year ended 31st December, 1950.
2. Depreciation is not provided in respect of Freehold Land.
3. Gross Earnings have been increased by £65,369 net adjustments relating to previous years.

£4,080,873£9,886,129**Consolidated Revenue Account for the year ended 31st Dec. 1950 Cr.**

1949	1950	
£	31st December	£
2,631,426	I. BY NET EARNINGS	7,136,038
	Brought from Profit and Loss Account	
35,568	II. " AMOUNTS WITHDRAWN FROM SUNDRY PROVISIONS NOT REQUIRED	71,888

£2,666,992£7,207,926

1950		
14th June		
264,741	III. BY BALANCE	536,688
	Brought from previous year	
	31st December	
1,033,917	IV. BY BALANCE	2,774,187
	Brought down	

£1,298,653£3,299,795

REPORT OF DIRECTORS

Your Directors submit their Report and Accounts for the year ended 31st December, 1950.

The Net Earnings of the Organization on Trading, including Interest Received, amounted to £7,136,038, after making full provision for depreciation of Assets.

To the sum of £7,136,038 there must be added the Amounts withdrawn from Provisions no longer required, £71,838, and the Balance brought forward from last year of £525,658, giving a total of £7,733,534.

At a Board Meeting held on the 16th October, 1950, an Interim Dividend of 10% free of Income Tax on the Ordinary Stock was declared. This accounted for £265,000 of the Earnings.

After meeting that sum (£265,000), the net amount of Dividend paid on the Preference Stock (£123,750), Taxation (£4,108,270), and Amounts set aside to Reserve Accounts (£325,469), there remains a balance of £2,911,045.

The Directors recommend that this sum be dealt with in the following manner:—

	£
By payment of a Final Dividend of 17% on the Ordinary Stock, free of Income Tax	450,500
By Transfer to General Reserve Account	1,906,960
And by carrying forward to next year the balance of	553,585
	£2,911,045

In accordance with the Articles of Association of the Company, all the Directors, with the exception of the Chairman, Viscount Nuffield, and the Vice-Chairman, Mr. R. F. Hanks, will retire at the Annual Meeting and, being eligible, offer themselves for re-election.

Messrs. Thornton & Thornton have indicated their willingness to continue as Auditors.

Signed on behalf of the Directors,

NUFFIELD,

9th May, 1951.

Chairman.

HOW THE MONEY WAS SPENT IN 1950

	£	%	£ s. d.
Income from Sales	60,980,000	99.7	19 11½
Income from Investments	35,000	0.1	0½
Withdrawn from Provisions, and adjustments re previous years	137,000	0.2	0½
	<u>£61,152,000</u>	<u>100.0%</u>	<u>£1 0 0</u>
Purchases of Materials and Supplies, including Stock Variation	38,218,000	62.5	12 6
Expenses (including Rates, Insurance, Maintenance, Power, Heating, Lighting, Carriage, Guarantee, Postages, Telephone, Printing, Stationery, Advertising, National Insurance, Professional Charges, etc.), less Sundry Credits	3,661,000	6.0	1 2½
Wages and Salaries (excluding Welfare)	10,828,000	17.7	3 6½
Taxation	4,108,000	6.7	1 4
Depreciation and Obsolescence of Plant and Buildings ..	677,000	1.1	2½
Welfare, including Holiday Pay, Staff Pension Fund, Provident Clubs, Gratuities, Expenses of Medical Centres, Canteens, etc.	561,000	0.9	2½
Net Dividends to Stockholders:—			
Nuffield Benefaction for Employees, being Dividends on 1,000,000 Ordinary Units	67,000	0.1	0½
Charitable Trusts endowed by Lord Nuffield, being Dividends on 6,809,524 Ordinary Units	460,000	0.8	2
General Preference and Ordinary Stockholders	312,000	0.5	1½
	£		
Net Amount Invested in the Business:—			
Reserves set aside	2,232,000		
Increase in amount carried forward	28,000		
	<u>2,260,000</u>	<u>3.7</u>	<u>8½</u>
	<u>£61,152,000</u>	<u>100.0%</u>	<u>£1 0 0</u>

IMPERIAL CHEMICAL

Balance Sheet at

1949 £		£	£	£
	I. SHARE CAPITAL AND RESERVES			
	CAPITAL			
24,081,956	Authorised in Shares of £1 each			
60,558,139	7 per cent. Cumulative Preference Shares	24,081,956		
10,359,905	Ordinary Shares	60,558,139		
	Unclassified Shares	10,359,905		
<u>£95,000,000</u>		<u>£95,000,000</u>		
	Issued and converted into Stock			
24,077,691	7 per cent. Cumulative Preference Stock	24,077,691		
60,558,139	Ordinary Stock	60,558,139		
<u>84,635,830</u>		<u>84,635,830</u>		
	CAPITAL RESERVES			
	General			
4,960,079	As at 31st December, 1949	4,960,079		
2,111,800	E.P.T. Post-War Refund	2,111,800		
—	Net surplus on realisations of fixed Assets during 1950	184,487		
	Amount freed on Revaluation of Physical Assets at 1st January, 1950, being Central Obsolescence and Depreciation Provision and writings off Physical Assets to 31st December, 1949	58,227,768		
<u>9,777,450</u>		<u>65,484,134</u>		
	SHARE PREMIUM ACCOUNT	9,777,450		
—	REVALUATION OF PHYSICAL ASSETS AT 1ST JANUARY, 1950			
—	Surplus in excess of £58,227,768, freed as above	37,892,505		
<u>16,849,329</u>	OBsolescence and REPLACEMENT OF ASSETS	<u>5,000,000</u>		
	Appropriated from Profits for year 1950		118,154,089	
	REVENUE RESERVES			
17,441,648	GENERAL	17,441,648		
502,580	METAL STOCKS CONTINGENCY	502,580		
—	STOCK REPLACEMENT			
4,328,249	Appropriated from Profits for year 1950	4,000,000		
<u>22,272,477</u>	PROFIT AND LOSS APPROPRIATION ACCOUNT	<u>4,424,588</u>		
<u>123,757,636</u>		<u>36,868,816</u>		
		<u>229,158,786</u>		
	II. FUTURE UNITED KINGDOM INCOME TAX			
1,764,000	Reserve for estimated liability 1951/52	6,885,879		
4,891,000	Reserve for deferred liability due to initial allowances ..	7,861,000		
<u>6,655,000</u>		<u>14,536,879</u>		
	III. UNSECURED LOANS			
—	4 per cent. Stock Repayable 1958/60	20,000,000		
595,564	4 per cent. Loan Repayable by 1958	535,442		
<u>595,564</u>		<u>20,535,442</u>		
	IV. CURRENT LIABILITIES AND PROVISIONS			
16,125,492	Sundry Creditors, Short-term Deposits and Accrued Charges	18,826,673		
—	Bank Overdraft: Secured	1,278,750		
379	Unsecured	—		
17,623,281	Provisions for Taxation, Deferred Repairs and Specific Liabilities	15,336,930		
200,000	War Personnel Provision	200,000		
2,794,384	Dividends (less tax) provided as shown in Profit and Loss Appropriation Account	3,524,868		
<u>36,744,136</u>		<u>38,967,221</u>		
<u>£167,752,336</u>		<u>£308,198,277</u>		

J. L. ARMSTRONG, Treasurer.

INDUSTRIES LIMITED

31st December, 1950

1949		At cost or as revalued at 1st Jan., 1950	Amounts written off	Net Book Value
£	I. FIXED ASSETS	£	£	£
20,800,966	PHYSICAL ASSETS	51,173,328	1,775,151	49,398,177
43,745,830	Land and Buildings	130,327,980	6,115,115	124,212,865
2,707,692	Plant and Machinery	5,242,408	707,469	4,534,939
67,254,288	Transport and Rolling Stock, etc.	£186,743,716	£8,597,735	178,145,981
1,298,475	Loose Tools, Office Furniture and Sundry Equipment at net book value at 31st December, 1950			1,443,583
68,540,763				179,589,564
15,043,766	INTANGIBLE ASSETS at cost less amounts written off Patents, Processes, Mineral Rights, Trade Marks and Goodwill ..			15,043,876
	II. INTERESTS IN SUBSIDIARIES AND ASSOCIATED COMPANIES			
	SHARES IN AND ADVANCES TO AND FROM SUBSIDIARIES including Dividends (less tax) due for the year 1950			
10,806,977	SHARES at cost or as revalued less provisions and amounts written off		13,875,990	
7,563,333	ADVANCES TO SUBSIDIARIES		12,449,374	
15,170,310			26,325,264	
7,040,650	Less: ADVANCES FROM SUBSIDIARIES		5,701,764	
11,129,660				20,423,500
15,086,950	SHARES AND DEBENTURES IN ASSOCIATED COMPANIES at cost or as revalued		13,794,432	
2,714,549	Less: Provisions and amounts written off		2,460,016	
12,372,401				11,334,416
	III. CURRENT ASSETS			
36,788,334	Stocks of Raw Materials, Stores, Finished Goods, etc., at or under cost	41,312,121		
17,855,309	Sundry Debtors, Housing and Other Loans and Payments in Advance	21,778,640		
1,000	Loan to Trustees of Employees' Share Investment Scheme	2,500		
1,722,326	Marketable Investments at cost (Market value £3,304,980)	1,722,326		
4,298,777	Tax Reserve Certificates	6,000,000		
60,865,746	Cash at Bankers and in hand	5,991,334		76,806,921

J. ROGERS
S. P. CHAMBERS } Directors.

£167,753,326

£208,198,277

Consolidated Profit and Loss Account **of Imperial Chemical Industries Limited and 100 Subsidiaries** **for the year ended 31st December 1950**

(1949 figures cover I.C.I., Ltd., and 98 subsidiaries)

1949
£

15,830,493

MANUFACTURING AND TRADING PROFITS *less* LOSSES after charging
the items inset below

28,922,384

1949									
£	£					£		£	
6,660,622		DEPRECIATION	..	..	..			8,694,823	
		PAYMENTS TO CONTRIBUTORY PENSION							
		FUNDS FOR STAFF, FOREMEN AND							
		WORKERS, DISCRETIONARY PENSIONS							
		AND GRATUITIES (including provisions							
		of £480,000 (1949 £120,000) towards							
		anticipated future solvency guarantee							
		payments and £638,000 (1949 £159,600)							
		towards the cost of increased pension							
		benefits for staff and foremen) ..						4,011,343	
2,771,383		REMUNERATION OF AUDITORS (including							
		expenses)							
		Imperial Chemical Industries, Ltd.							
	23,152	and operating Divisions ..				26,225			
	30,397	Subsidiaries ..				36,353			
53,549								62,578	

1,377,480

REVENUE FROM ASSOCIATED COMPANIES

2,355,826

222,229

REVENUE FROM MARKETABLE INVESTMENTS AND OTHER SECURITIES

903,065

189,729

REVENUE FROM PROPERTY

191,677

66,651

INTEREST AND MISCELLANEOUS INCOME (INCLUDING TRANSFER FEES)

68,738

17,686,562

31,741,640

149,678	Less: DEBENTURE AND FIXED LOAN INTEREST	..	..	..	..	£	366,939
213,375	OTHER LOAN INTEREST	..	..	..	..		337,244
363,053							729,183

17,323,509

CONSOLIDATED INCOME BEFORE TAXATION

31,018,457

Less: TAXATION (BASED ON INCOME OF THE YEAR)

2,976,426	U.K. Profits Tax	..	..	..	..	..	3,102,376
3,724,920	U.K. Income Tax	..	..	..	..	..	9,667,547
293,252	Overseas Taxes (net after reliefs)	..	..	..	..	..	678,229
6,994,597							15,348,152
497,769	Less: Overprovisions in past years	..	..	..	..	..	2,892,480
6,496,828							12,455,692

£10,826,681

CONSOLIDATED INCOME AFTER TAXATION CARRIED FORWARD TO
NEXT PAGE

£18,563,765

1949			£
£			
10,826,681	CONSOLIDATED INCOME AFTER TAXATION BROUGHT FORWARD FROM PREVIOUS PAGE		18,562,765
—	Less: APPROPRIATION BY SUBSIDIARIES TO RESERVE FOR DEFERRED INCOME TAX LIABILITY DUE TO INITIAL ALLOWANCES		106,186
10,826,681			18,456,580
281,517	Less: NET DIVIDENDS OF SUBSIDIARIES APPROPRIATE TO MINORITY MEMBERS	376,768	£
198,684	UNDISTRIBUTED INCOME OF SUBSIDIARIES APPROPRIATE TO MINORITY MEMBERS	229,052	
480,201			606,820
10,346,480			17,850,760
554,977	Less: UNDISTRIBUTED INCOME OF SUBSIDIARIES APPROPRIATE TO IMPERIAL CHEMICAL INDUSTRIES, LTD.		1,006,848
£9,791,503	NET INCOME OF IMPERIAL CHEMICAL INDUSTRIES, LTD., FOR THE YEAR CARRIED TO PROFIT AND LOSS APPROPRIATION ACCOUNT ..		£16,843,912

Profit and Loss Appropriation Account of Imperial Chemical Industries Limited for the year ended 31st December 1950

1949			£
£			
9,791,503	NET INCOME OF IMPERIAL CHEMICAL INDUSTRIES, LTD., FOR THE YEAR 1950 FROM CONSOLIDATED PROFIT AND LOSS ACCOUNT		16,843,912
4,009,435	Add: BALANCE BROUGHT FORWARD FROM 1949		4,328,249
13,800,938			21,172,161
	Less: APPROPRIATIONS	£	£
2,215,000	RESERVE FOR DEFERRED INCOME TAX LIABILITY DUE TO INITIAL ALLOWANCES		2,960,000
1,500,000	Central Obsolescence and Depreciation Provision		—
500,000	Capital Reserve—General		—
—	CAPITAL RESERVE—Obsolescence and Replacement of Assets		5,000,000
1,000,000	Revenue Reserve—General		—
—	REVENUE RESERVE—Stock Replacement		4,000,000
	DIVIDENDS (LESS TAX) FOR 1950		
	Paid		
463,496	(a) 7 per cent. Cumulative Preference Stock, half-year to 30th June, 1950	463,496	
999,209	(b) Ordinary Stock, Interim Dividend 3 per cent.	999,209	
1,462,705			1,462,705
	Provided		
463,496	(a) 7 per cent. Cumulative Preference Stock, half-year to 31st December, 1950	463,496	
2,331,488	(b) Ordinary Stock, Final Dividend 9 per cent.	2,861,372	
2,794,984			3,324,868
9,472,689			16,747,578
£4,328,249	BALANCE CARRIED TO BALANCE SHEET		£4,494,588

Consolidated Balance Sheet of Imperial Chemical Industries

(1949 figures cover I.C.I. Ltd.)

1949 £		Authorised in Shares of £1 each	Issued and converted into Stock
	I. SHARE CAPITAL AND SURPLUS OF MEMBERS OF IMPERIAL CHEMICAL INDUSTRIES, LIMITED		
	CAPITAL	£	£
24,077,691	7 per cent. Cumulative Preference Shares	24,081,956	24,077,691
60,558,139	Ordinary Shares	60,558,139	60,558,139
—	Unclassified Shares	10,359,905	—
84,635,830		<u>£95,000,000</u>	<u>84,635,830</u>
	SURPLUS		
18,517,858	On Capital Account	121,005,423	
26,051,420	On Revenue Account	31,295,002	
44,569,278			<u>152,300,425</u>
129,205,108			236,936,255
6,822,191	II. SHARE CAPITAL AND SURPLUS OF MINORITY MEMBERS OF SUBSIDIARIES		8,624,649
	III. FUTURE UNITED KINGDOM INCOME TAX		
2,801,215	Reserve for estimated liability 1951/52 ..	8,169,635	
4,891,000	Reserve for deferred liability due to initial allowances	7,997,185	
7,692,215			<u>16,166,820</u>
	IV. DEBENTURES AND LOANS		
3,239,869	Debentures and Secured Loans (Subsidiaries)	3,293,809	
595,564	Unsecured Loans (Parent Company) ..	20,535,442	
3,835,433			<u>23,829,251</u>
	V. CURRENT LIABILITIES AND PRO- VISIONS	£	
24,412,993	Sundry Creditors, Bills Pay- able, Short-term Deposits and Accrued Charges ..	28,307,910	
—	Bank Overdrafts: Secured ..	1,394,130	
5,359,200	Unsecured	<u>4,428,681</u>	
		5,822,811	
22,709,832	Provisions for Taxation, De- ferred Repairs and Specific Liabilities	20,063,217	
200,000	War Personnel Provision ..	200,000	
2,794,984	I.C.I., Ltd., Final Dividends (Net)	<u>3,324,868</u>	
55,477,009			<u>57,718,806</u>
<u>£203,031,956</u>			<u>£343,275,781</u>

J. L. ARMSTRONG, *Treasurer.*

at 31st December 1950
 Limited and 100 Subsidiaries
 and 93 subsidiaries)

1949, £	I. FIXED ASSETS	At cost or as revalued principally at 1st January, 1950	Amounts written off	Net Book Value
	PHYSICAL ASSETS	£	£	£
29,722,227	Land and Buildings ..	64,818,051	4,664,008	60,154,043
46,942,587	Plant and Machinery ..	139,811,097	10,714,657	129,096,440
3,332,967	Transport and Rolling Stock, etc.	6,704,977	1,384,388	5,320,589
79,997,781		<u>£211,334,125</u>	<u>£16,763,053</u>	194,571,072
	Loose Tools, Office Furniture and Sundry Equipment at net book value at 31st December, 1950			1,868,171
1,614,097				
81,611,878				196,439,243
	INTANGIBLE ASSETS at cost less amounts written off			
15,737,921	Patents, Processes, Mineral Rights, Trade Marks and Goodwill			16,609,881
	II. INTERESTS IN SUBSIDIARIES AND ASSOCIATED COMPANIES			
10,287	<i>Shares in Subsidiaries not consolidated, at cost less amounts written off</i>			—
16,245,922	SHARES AND DEBENTURES IN ASSOCIATED COMPANIES at cost or as revalued ..		19,516,169	
2,746,412	Less: Provisions and amounts written off ..		2,739,537	
13,499,510				16,776,632
	III. CURRENT ASSETS			
55,067,431	Stocks of Raw Materials, Stores, Finished Goods, etc., at or under cost		59,935,802	
27,664,150	Sundry Debtors, Housing and Other Loans, and Payments in Advance		35,759,046	
2,265,708	Marketable Investments at cost (Market value £3,927,651)		2,236,158	
614,884	British Government Securities at cost (Market value £705,248)		721,359	
800	Tax Reserve Certificates		6,000,000	
6,559,387	Cash at Bankers and in hand		8,797,660	
92,172,360				113,450,025
<u>£203,031,956</u>	J. ROGERS S. P. CHAMBERS } <i>Directors.</i>			<u>£343,275,781</u>

AERATED BREAD COMPANY

Aerated Bread Company Limited and Subsidiary

as at 30th

1949				1950			
Group	Aerated Bread Co., Ltd.			Aerated Bread Co., Ltd.			Group
£	£	£	£	£	£	£	£
LIABILITIES							
CAPITAL—							
<i>Authorised:</i>							
		750,000		750,000			
		1,500,000		1,500,000			
		<u>2,250,000</u>		<u>2,250,000</u>			
<i>Issued:</i>							
		6½ per cent. Cumulative Preference Stock		732,542			732,542
732,542		732,542					
<u>1,282,000</u>		<u>1,282,000</u>		<u>1,282,000</u>			<u>1,282,000</u>
	2,014,542	2,014,542			2,014,542	2,014,542	
RESERVES AND SURPLUS—							
126,794		126,794		126,794			126,794
Revenue Reserves:							
400,000		400,000		450,000			450,000
—		—		100,000			100,000
31,537		31,537		31,537			31,537
81,855		81,855		66,438			66,438
<u>513,392</u>		<u>513,392</u>		<u>647,975</u>			<u>647,975</u>
	640,186	640,186			774,769	774,769	
Excess of Parent Company's Share of Subsidiary Companies' Net Assets over Book Value of investment therein, represented by:—							
							39,974
66,207							82,018
<u>82,342</u>							
	148,549	—			—	121,992	
	2,803,277	2,654,728			2,789,311	2,911,303	
TOTAL CAPITAL, RESERVES AND SURPLUS							
PROVISION FOR LIABILITY TO INCOME TAX 1951/52 (payable 1st January 1952)							
(1950/51)	150,864	143,866 (1950/51)			94,430	108,330	
INTEREST OF OUTSIDE SHAREHOLDERS IN SUBSIDIARY COMPANIES—							
							10,720
10,822							
1,453							1,295
	12,275	—				12,015	
PROVISION FOR STAFF PENSIONS							
				100,000			100,000
				11,337			11,337
	100,000	100,000			88,663	88,663	
CURRENT LIABILITIES—							
		232,892		227,866			333,787
318,216							
746,942		673,117		725,380			798,060
70,510		70,510		70,510			70,510
	1,135,668	976,519			1,023,746	1,309,337	
NOTE: There are Capital Commitments estimated at £42,500 (Group £50,000.)							
	<u>£4,201,884</u>	<u>£3,375,113</u>			<u>£3,906,160</u>	<u>£4,330,548</u>	

LIMITED—BALANCE SHEET

Companies—Consolidated Balance Sheet of the Group

September, 1950

NOTE. The Group figures appear in red.

1949				ASSETS		1950			
Group		Aerated Bread Co., Ltd.				Aerated Bread Co., Ltd.		Group	
£	£	£	£			£	£	£	£
FIXED ASSETS—									
Freehold and Leasehold Properties:									
Valuations, <i>plus</i> Additions at Cost, <i>less</i>									
2,462,827		2,253,881		Sales, to date	2,310,862			2,427,788	
681,391		648,163		Depreciation to date	424,269			495,110	
	1,781,436	1,605,718				1,886,593	2,002,648		
Plant, Machinery, Fixtures, Fittings, Equipment and Motor Vans:									
Valuations, <i>plus</i> Additions at Cost, <i>less</i> Sales, to date									
1,416,874		1,318,295		Depreciation to date	1,021,471			1,146,799	
913,099		850,957			543,447			610,397	
	503,775	467,338				478,034	536,502		
	2,285,211	2,073,056				2,364,617	2,539,150		
SUBSIDIARY COMPANIES—									
Investments, at Cost									
		118,249		Current Accounts	118,308				
		5,497			6,566				
	123,746					124,875			
TRADE INVESTMENTS—at Cost, <i>less</i> amounts written off									
	5,420	4,418				4,418	5,420		
STAFF PENSIONS—INVESTMENT—									
	60,000	60,000		3 per cent. Savings Bonds 1960/70, at Cost (Market Value 30th September, 1960, £58,950)					
						60,000	60,000		
SUSPENSE ACCOUNT—									
Expenditure on Rehabilitation and Deferred Repairs as per last Balance Sheet									
				Add: Expenditure during the year ..	157,467			157,467	
157,467	157,467				54,226	211,692	211,692		
CURRENT ASSETS—									
Stocks and Stores, as Certified by Officials of the Companies									
244,495		192,211		Trade Debtors and Prepayments ..	204,139			271,997	
75,166		58,944		Agreed Chattel Claims under the War Damage Act, 1943	64,823			101,514	
127,908		111,588		Tax Reserve Certificates	111,588			127,908	
440,000		440,000		Balances at Bank and Cash in Hand ..	295,000			295,000	
803,217		653,633			554,998			707,867	
	1,693,786	1,456,426				1,230,548	1,504,286		

J. G. GIRDWOOD } Directors
H. A. YATES }

£4,201,884 £3,875,113

£3,996,150 £4,330,848

AERATED BREAD COMPANY LIMITED **and SUBSIDIARY COMPANIES**

Consolidated Profit and Loss Account **for the year ended 30th September, 1950**

1949			1950
£	£		£
		The Balance of Consolidated Profits, before taking into account the items below, amounts to	412,848
	512,025	Add: Dividends received (Gross) on Trade Investments	336
	371		
	<u>512,396</u>		<u>413,184</u>
		<i>Deduct:</i>	
		Taxation (estimated on Profits for Year to date)	
		Income Tax	133,552
		Profits Tax	72,577
187,834	264,344		206,129
76,510	78,298	Depreciation on Properties and Plant	59,105
	—	Pension Scheme—Current Service Contributions	6,685
	<u>342,642</u>		<u>271,919</u>
	169,754	NET PROFIT	141,265
	334	Less: Interest of Outside Shareholders in Profit of Subsidiary Companies	308
	<u>169,420</u>		<u>140,957</u>
		Less: Profit for the year retained by Subsidiary Companies attributable to the Aerated Bread Company, Limited (page 7)	9,676
	9,665		
	<u>159,755</u>	NET PROFIT OF THE AERATED BREAD COMPANY, LIMITED	131,281
	68,798	Add: Surplus from previous Year	81,855
	<u>228,553</u>		<u>213,136</u>
		BALANCE AVAILABLE FOR DISPOSAL BY THE AERATED BREAD COMPANY, LIMITED	
		Which has been appropriated as follows:	
	50,000	Transfer to General Reserve (page 7)	50,000
	26,188	Preference Dividend, less Tax	26,188
		Dividend Recommended: 10 per cent. on Ordinary Stock for Year ended 30th September, 1950, less Tax	70,510
	70,510	Surplus carried forward	66,438
	81,855		
	<u>£228,553</u>		<u>£213,136</u>

Statement pursuant to Section 196 of the Companies Act, 1948.

The remuneration by the Group to Directors of the Aerated Bread Company, Limited,

for the Year ended 30th September, 1950, was—

Fees as Directors	£8,950
Managerial Remuneration	10,110
Pension Scheme—Current Service Contributions	469

£19,529

Pension Scheme—Past Service Contributions

£3,870

AERATED BREAD COMPANY LIMITED and SUBSIDIARY COMPANIES

Movement in Reserves

for the year ended 30th September, 1950

NOTE. The parent company's proportion of Subsidiary Companies' Reserves appear in red.

	Aerated Bread Co., Ltd.		Parent Company's proportion of Subsidiary Companies' Reserves	
	General Reserve	Contingencies Reserve	Capital Reserve	Revenue Reserves
	£	£	£	£
Balances: 1st October, 1949	400,000		66,207	82,342
Add: Appropriation from Profit	50,000			
Difference between purchase price and nominal value of shares acquired in Subsidiary Company			40	
Profit for the Year retained by the Subsidiary Companies				9,676
Provision no longer required for Depreciation of Fixed Assets consequent upon the settlement of War Damage Claims ..		100,000		
			66,247	
Deduct: Excess of purchase price over value of net assets in Subsidiary Company acquired during year			16,600	
Excess of Book Value over proceeds on realisation of Freehold Properties and Professional Charges written off ..			19,673	
			36,273	
Balances: 30th September, 1950	450,000	100,000	29,974	92,018

AUDITORS' REPORT

To the Members of Aerated Bread Company, Limited.

We have obtained all the information and explanations which, to the best of our knowledge and belief were necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Company so far as appears from our examination of those books. We have examined the Balance Sheet, set out on pages 4 and 5, which is in agreement with the books of account. In our opinion, and to the best of our information and according to the explanations given us, the said Balance Sheet gives the information required by the Companies Act, 1948, in the manner so required, and a true and fair view of the state of the Company's affairs as at 30th September, 1950.

We have also examined the Consolidated Balance Sheet, set out on pages 4 and 5, and Consolidated Profit and Loss Account, set out on page 6, of the Company and its Subsidiaries dealt with thereby with the audited accounts of those Companies. In our opinion such Consolidated Balance Sheet and Consolidated Profit and Loss Account have been properly prepared in accordance with the provisions of the Companies Act, 1948, so as to give a true and fair view, respectively, of the state of affairs and of the profit of Aerated Bread Company, Limited and its Subsidiaries dealt with thereby so far as concerns members of Aerated Bread Company, Limited.

GIBSON HARRIS & CO.,

Chartered Accountants.

BALTIC HOUSE, 27, LEADENHALL STREET, E.C.3.

1st December, 1950.

MARKS AND SPENCER LIMITED

DIRECTORS

SIR SIMON MARKS, D.Sc., *Chairman and Joint Managing Director*

ISRAEL M. SIEFF, B.Com., *Vice-Chairman and Joint Managing Director*

J. EDWARD SIEFF, *Assistant Managing Director*

HARRY SACHER, M.A.

NORMAN LASKI, M.A.

A. E. LEES

MICHAEL D. SIEFF.

RT. HON. L. S. AMERY, C.H.

W. F. NORRIS

Secretary:

B. W. GOODMAN, A.C.A.

Registered Office:

Michael House, 82, Baker Street, London, W.1.

REPORT OF THE DIRECTORS

The Directors have pleasure in submitting to the Shareholders the annexed Statement of Accounts for the year ended 31st March, 1951.

	1951	1950
PROFIT	£	£
The profit before providing for Taxation amounts to	6,082,264	4,651,102
which after making provision for Taxation of	3,525,000	2,530,000
leaves a balance of	2,557,264	2,121,102
to which must be added a transfer from Taxation Provision of	—	100,000
and the amount brought forward from last year of	3,971,401	2,593,874
making a total available for distribution of	<u>£6,528,665</u>	<u>£4,814,976</u>

APPROPRIATIONS

After making the following appropriations—

Allocation to Staff Benevolent and Pensions Fund	50,000	50,000
Transfer to General Reserve	505,321	—
Transfer to Stock Contingency Reserve	350,000	—
Transfer to Debenture Redemption Reserve	23,200	21,900
The Dividends, less Income Tax, on the—		
10 per cent. Cumulative Preference Shares for the year to 31st March, 1951	18,811	19,250
7 per cent. Cumulative Preference Shares for the year to 31st December, 1950	38,500	38,500
and an Interim Dividend of 15 per cent. on the Ordinary and "A" Ordinary Shares	182,538	178,481
The Directors recommend the payment of a Final Dividend of 60 per cent. less Income Tax on the Ordinary and "A" Ordinary Shares (payable on the 2nd July, 1951) making a total distribution of 75 per cent. less Income Tax for the year	696,962	535,444
leaving to be carried forward	4,663,333	3,971,401
	<u>£6,528,665</u>	<u>£4,814,976</u>

BONUS ISSUE.

It is proposed to capitalise a sum of £49,168 10s. od., being a part of the General Reserve Account, to enable a distribution by way of Bonus to the Ordinary and "A" Ordinary Shareholders of 196,674 shares of 5s. each fully paid in the proportion of one "A" Ordinary Share for every 45 Ordinary and/or "A" Ordinary Shares held.

RETIREMENT OF DIRECTORS.

In accordance with Article 108 of the Company's Articles of Association Mr. Norman Laski, M.A. and Mr. A. E. Lees retire by rotation from the Office of Directors, and being eligible, offer themselves for re-election.

AUDITORS.

The Auditors, Messrs. Deloitte, Plender, Griffiths & Co., have notified that they are willing to continue in office.

LONDON, W.I.

3rd May, 1951

SIMON MARKS

ISRAEL M. SIEFF

} *Directors.*

B. W. GOODMAN, *Secretary.*

**CERTIFICATE IN RESPECT OF THE ISSUED SHARE CAPITAL
AND DEBENTURE STOCK.**

In accordance with the instructions of the Board, I have audited the Share and Debenture Stock Registers of the Company for the year ended 31st March, 1951, and certify that all Transfers have been correctly recorded therein, that the relative certificates are properly authorised and that the balances on the Share and Debenture Stock Registers at the 31st March, 1951, agree with the total number of shares of the various classes and the amount of Debenture Stock issued at that date, as shown on the Balance Sheet overleaf.

IMPERIAL HOUSE,
DOMINION STREET, E.C.2.

3rd May, 1951.

N. WOOLLEY,
Chartered Accountant.

MARKS AND

Balance Sheet as at

1950		Authorised	Issued and fully paid	
£		£	£	£
	SHARE CAPITAL—			
350,000	350,000 10 per cent. CUMULATIVE PREFERENCE SHARES	350,000	350,000	
1,000,000	1,000,000 7 per cent. CUMULATIVE PREFERENCE SHARES	1,000,000	1,000,000	
600,000	2,400,000 ORDINARY SHARES of 5s. each	600,000	600,000	
	8,000,000 "A" ORDINARY SHARES of 5s. each, of which 6,460,309 have been issued	2,000,000	1,612,577	
1,563,409				
3,513,409		3,950,000		3,562,577
	CAPITAL RESERVE—			
906,984	SHARE PREMIUM ACCOUNT			906,984
	REVENUE RESERVES—			
2,343,847	GENERAL (after Capitalisation of £49,168)		3,000,000	
200,000	PROPERTIES CONTINGENCY	200,000		
	Less Transfer to General Reserve	200,000		
150,000	STOCK CONTINGENCY		500,000	
238,700	DEBENTURE REDEMPTION		261,900	
3,971,401	PROFIT AND LOSS ACCOUNT—Balance after proposed dividends and appropriations		4,663,333	8,426,233
6,903,948				
11,324,341				12,894,794
1,885,000	RESERVE FOR FUTURE INCOME TAX, assessable 1951/52			2,270,000
	DEBENTURE STOCK AND LOAN—			
783,200	FIRST MORTGAGE DEBENTURE STOCK—6 per cent.		761,300	
2,600,000	FIRST MORTGAGE DEBENTURE STOCK—3½ per cent.		2,500,000	
3,383,200			3,261,300	
1,000,000	LOAN AT 4 per cent. INTEREST		1,000,000	
4,383,200	(Secured by issue of £1,100,000 4½ per cent. First Mortgage Debenture Stock as collateral)			4,261,300
	CURRENT LIABILITIES AND PROVISIONS—			
2,230,017	CREDITORS AND ACCRUED CHARGES		2,786,168	
20,005	ACCRUED INTEREST (less Income Tax) on Debenture Stock and Loan (secured) ..		18,981	
	PROVISIONS FOR—			
910,257	Taxation, including Income Tax to 1950/51		1,371,953	
135,000	Deferred Repairs			
	DIVIDENDS, less Income Tax—			
9,825	10 per cent. Cumulative Preference Shares for half-year to 31st March, 1951		9,187	
535,444	Proposed Final Dividend on Ordinary and "A" Ordinary Shares ..	696,982		
3,840,348			706,149	4,883,346
£21,132,889				£24,309,340
	SIMON MARKS } Directors			
	ISRAEL M. SIEFF }			
	B. W. GOODMAN, Secretary			

REPORT OF THE AUDITORS TO THE MEMBERS

We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for our examination of those books and proper returns adequate for the purposes of our audit have been received from branches with the books of account and returns. In our opinion, and to the best of our information, and according to the explanations Sheet gives a true and fair view of the state of the Company's affairs as at 31st March, 1951, and the Profit and Loss Account.

We have also examined the group accounts comprising the accounts of the Company as audited by us and the statement been audited by us. In our opinion, such group accounts have been properly prepared in accordance with the provisions and Spencer, Limited, and its subsidiaries, so far as concerns members of Marks and Spencer, Limited.

5, LONDON WALL BUILDINGS, E.C.2.

3rd May, 1951.

SPENCER LIMITED

31st March, 1951

1950					
£			£	£	£
	FIXED ASSETS				
	PROPERTIES as valued at 10th June, 1936, <i>plus</i> additions at cost to 31st March, 1951				
6,911,689	Freeholds	.. .. .	7,046,806		
1,181,019	Less—Provision for Depreciation	.. .. .	1,370,585		
5,730,670				5,776,221	
3,376,453	Leaseholds	.. .. .	3,859,611		
1,228,298	Less—Provision for Depreciation	.. .. .	1,393,690		
2,648,155				2,565,921	
8,378,825				8,342,142	
1,196,040	FIXTURES AND EQUIPMENT—at cost, <i>less</i> depreciation	.. .. .	1,670,791		
9,574,865					10,012,983
1,241,503	TRADE INVESTMENTS, including Loan—at cost	.. .. .			1,886,503
10,816,368					11,899,486
	SUBSIDIARY COMPANIES (see Statement annexed)—				
21,156	SHARES—at cost	.. .. .		21,156	
1,134,245	ADVANCES	.. .. .		2,442,382	
1,155,401					2,463,538
	CURRENT ASSETS—				
2,394,258	STOCK IN TRADE at cost or under, as certified by Officials of the Company	.. .. .	4,372,048		
76,000	CONSUMABLE STORES	.. .. .	67,000		
644,550	DEBTORS AND AMOUNTS PAID IN ADVANCE	.. .. .	931,000		
	INVESTMENTS quoted on recognised Stock Exchange—at cost—				
1,324,601	British Government Securities	.. .. .	1,324,601		
49,534	Other Investments	.. .. .	49,534		
	(£10,995 deposited under Property Covenants)			1,374,135	
	Market Value—£1,379,653 (1950—£1,357,122)				
1,698,276	TAX RESERVE CERTIFICATES	.. .. .	1,500,000		
2,474,902	BALANCE AT BANKERS and CASH IN HAND	.. .. .	2,202,383		
9,161,120					10,446,466

Notes—

The Company has guaranteed to Bankers advances up to £198,000 (1950—£145,000) to a Subsidiary and other Companies.

£21,132,839

£24,309,840

OF MARKS AND SPENCER LIMITED

for the purposes of our audit. In our opinion proper books of account have been kept by the Company so far as appears from not visited by us. We have examined the above Balance Sheet and annexed Profit and Loss Account which are in agreement given us, the said accounts give the information required by the Companies Act, 1948, in the manner so required, and the Balance gives a true and fair view of the profit for the year ended on that date.

of interests in subsidiaries annexed thereto which is based on audited accounts of the subsidiaries, certain of which have not of the Companies Act, 1948, so as to give a true and fair view respectively of the state of affairs and of the profit of Marks

DELOITTE, PLENDER, GRIFFITHS & Co.,

Chartered Accountants, Auditors

MARKS AND

Profit and Loss Account for

1950 £		£	£
	DIRECTORS' EMOLUMENTS—		
2,500	Fees	2,500	
78,929	Other Emoluments	85,926	
<u>81,429</u>			88,426
500	DEBENTURE TRUSTEES' REMUNERATION		500
134,906	DEBENTURE STOCK INTEREST		133,616
40,000	LOAN INTEREST		40,000
	DEPRECIATION of—		
185,182	Properties	209,153	
502,640	Fixtures and Equipment	523,891	
<u>687,822</u>			733,044
	REPAIRS to—		
370,804	Properties	351,865	
299,928	Fixtures and Equipment	303,727	
<u>670,732</u>		655,592	
165,000	Less Amount attributed to Deferred Repairs ..	135,000	
505,732			520,592
4,651,102	BALANCE carried down		6,082,264
<u>£6,101,491</u>			<u>£7,598,442</u>
	TAXATION on the profit for the year—		
755,000	Profits Tax	1,120,000	
1,775,000	Income Tax (including Reserve of £2,270,000 for future Income Tax, assessable 1951/52)	2,405,000	
<u>2,530,000</u>			3,525,000
50,000	ALLOCATION TO STAFF BENEVOLENT AND PENSIONS FUND		50,000
—	TRANSFER TO GENERAL RESERVE		505,321
—	TRANSFER TO STOCK CONTINGENCY RESERVE		350,000
21,900	TRANSFER TO DEBENTURE REDEMPTION RESERVE ..		23,200
	DIVIDENDS, less Income Tax, paid and proposed on—		
19,250	10% Cumulative Preference Shares for the year to 31st March, 1951		18,811
38,500	7% Cumulative Preference Shares for the year to 31st December, 1950		38,500
	Ordinary and "A" Ordinary Shares—		
178,481	15% Interim paid	182,538	
535,444	60% Final proposed	696,962	
			879,500
3,971,401	BALANCE proposed to be carried forward		4,663,333
<u>£7,344,976</u>			<u>£10,053,665</u>

SPENCER LIMITED

the year ended 31st March, 1951

1950 £		£	£
5,989,951	PROFIT for the year before taking into account income set out below and expenditure and charges <i>per contra</i>		7,486,863
	INTEREST AND DIVIDENDS ON—		
51,452	Trade Investments	51,806	
45,267	Other Investments	52,632	
96,719			104,438
10,945	BANK AND OTHER INTEREST		6,160
870	TRANSFER FEES		981
3,006	Profit on Sale of Investment		—
<u>£6,101,491</u>			<u>£7,598,442</u>
4,651,102	BALANCE brought down		6,082,264
100,000	Transfer from Taxation Provision, amount no longer required		—
2,593,874	BALANCE BROUGHT FORWARD FROM LAST ACCOUNT..		3,971,401
<u>£7,344,976</u>			<u>£10,053,665</u>

MARKS AND SPENCER LIMITED

Statement in respect of Interests in Subsidiaries (Wholly Owned) as at 31st March, 1951

1950			
£	£	£	£
		ASSETS AND LIABILITIES OF SUBSIDIARIES:	
		FIXED ASSETS:	
	8,701	Furniture, Fixtures and Equipment at cost, less Depreciation	15,329
		CURRENT ASSETS:	
595,982		Stock in Trade at cost or under	1,334,800
807,326		Debtors and Amounts paid in Advance ..	1,569,055
51,949		Balances at Bankers and Cash in hand ..	56,669
	<u>1,455,257</u>		<u>2,960,524</u>
	1,463,958		2,975,853
		Less CURRENT LIABILITIES:	
	145,534	Creditors and accrued charges, including provision for Income Tax to 1950/51 ..	235,760
	<u>1,318,424</u>		<u>2,740,093</u>
		NET ASSETS	
	1,155,401	COST OF SHARES IN AND ADVANCES TO SUBSIDIARIES per Balance Sheet of Marks & Spencer, Ltd.	2,463,438
	<u>£163,023</u>	EXCESS	<u>£276,655</u>
		Comprising—	
		CAPITAL RESERVES—	
		Excess of net assets at date of acquisition over cost of Shares	4,536
4,536		E.P.T.—Post-war Refund	4,194
4,194	8,730		<u>8,730</u>
		REVENUE RESERVES—	
26,863		Stock Contingency	61,721
80,178		Undistributed Profits	130,141
47,252		Reserve for Future Income Tax assessable 1951/52	76,063
	<u>154,293</u>		<u>267,925</u>
	<u>£163,023</u>		<u>£276,655</u>
		SUMMARY OF PROFIT AND LOSS ACCOUNTS OF SUBSIDIARIES for the year to 31st March, 1951 (exclusive of figures of Marks & Spencer Export Corporation, Ltd., which are incorporated in the accounts of Marks & Spencer, Ltd.)	
	111,340	PROFIT for the year (after charging Depreciation £2,156) (1949/50—£1,545)	179,021
		TAXATION thereon—	
12,000		Profits Tax	18,137
47,252		Income Tax (assessable 1951/52)	76,063
	<u>59,252</u>		<u>94,200</u>
	52,088	BALANCE FOR THE YEAR	84,821
	8,730	TRANSFERRED TO STOCK CONTINGENCY RESERVE	34,858
	<u>43,358</u>		<u>49,963</u>
	36,820	AMOUNT BROUGHT FORWARD FROM PREVIOUS YEAR	80,178
	<u>£80,178</u>	UNDISTRIBUTED PROFITS carried forward in accounts of Subsidiaries	<u>£130,141</u>

OLYMPIA

Balance Sheet as at

(Adjusted)

31st December, 1949			
£	£		£
		SHARE CAPITAL AUTHORISED:	
1,000,000		1,000,000 5% Cumulative Preference Shares of	1,000,000
500,000		£1 each	500,000
		4,000,000 Ordinary Shares of 2/6 each	
<u>£1,500,000</u>			<u>£1,500,000</u>
		SHARE CAPITAL ISSUED AND FULLY PAID:	
	850,000	850,000 5% Cumulative Preference Shares of £1	850,000
	425,000	each	425,000
1,275,000		3,400,000 Ordinary Shares of 2/6 each	1,275,000
		CAPITAL RESERVE:	
	199,565	General	199,565
	—	Add: Profit on redemption of	
		Debentures during year	2,195
			<u>201,760</u>
		REVENUE RESERVES:	
	15,000	Special	30,600
	5,000	General	5,000
		Estimated Income Tax Schedule D,	
	76,000	1951/52	40,000
	—	Dividend Equilisation	15,000
		Profit and Loss Account Balance	
	67,625	unappropriated	66,511
			<u>157,111</u>
363,190			358,871
1,638,190			1,633,871
		4% FIRST MORTGAGE DEBENTURE STOCK:	
	1,200,000	Amount authorised and issued	1,200,000
	—	Less: Stock redeemed or cancelled to date	37,915
1,200,000			<u>1,162,085</u>
		CURRENT LIABILITIES AND PROVISIONS:	
	39,805	Sundry Creditors and accrued charges	32,536
	58,615	Deposits against future Exhibitions	74,865
		Provision for Deferred Repairs and Maintenance	
	42,300	Equilisation	20,877
		Provision for Taxation to date including Schedule	
	64,000	D, 1950/51	94,349
		Interest accrued on 4% First Mortgage Debenture	
	13,200	Stock, less Income Tax, paid 1st January, 1951	12,783
		Dividend accrued on 5% Cumulative Preference	
	3,896	Shares, less Income Tax, paid 30th April, 1951	3,719
		Provision for proposed Ordinary Dividend, less	
	9,350	Income Tax	8,925
231,166			<u>248,054</u>
<u>£3,069,356</u>			<u>£3,044,010</u>

REPORT OF THE AUDITORS TO THE

In our opinion and to the best of our information and according to the explanations view of the state of the company's affairs as at 31st December, 1950, and of its profit for the best of our knowledge and belief were necessary for our audit. In our opinion the company therewith, give in the prescribed manner the information required by the Companies Act, 1948.

3, Frederick's Place,

Old Jewry, London, E.C.2.

21st May, 1951.

LIMITED

31st December, 1950

to nearest £)

31st December, 1949					
£	£	FIXED ASSETS:		£	£
		FREEHOLD LAND AND BUILDINGS as per Valuation			
		by Messrs. Goddard & Smith, dated 17th			
	2,169,932	February, 1930, less sundry sales		2,169,932	
	309,314	Additions since at cost less sales		309,314	
2,479,246					2,479,246
		PLANT, MACHINERY, FURNITURE, FIXTURES,			
		FITTINGS AND EXHIBITION ACCESSORIES			
		Nominal Value as at 31st December,			
	100	1946		100	
	91,825	Additions since, at cost		127,646	
					127,746
	91,925	Less: Sale of Plant, at cost		33,001	
					94,745
		Less: Provision for Depreciation on above			
		(net)			16,815
72,308	19,617				77,930
					2,557,176
2,551,554		CURRENT ASSETS:			
		Sundry Debtors, Work in Progress and Prepay-			
	103,341	ments, less provision for doubtful debts ..		114,547	
		Investments at cost, less amounts written off:			
					£
	2	Subsidiary Companies		2	
	5,192	Quoted			
	1,051	Unquoted		1,051	
					1,053
	34,025	Tax Reserve Certificates		75,000	
	374,191	Balances with Bankers and Cash in hand ..		296,234	
517,802					486,834

H. OLIVER-KING

CHAS. P. HESELDEN

} Directors.

£3,069,356

£3,044,010

MEMBERS OF OLYMPIA, LIMITED.

given to us, the above balance sheet and the annexed profit and loss account give a true and fair year ended on that date. We have obtained all the information and explanations which to the has kept proper books of account, and the above-mentioned accounts, which are in agreement

PRICE WATERHOUSE & CO.

Chartered Accountants.

} Auditors.

OLYMPIA

Profit and Loss Account for the

1949		£
	Depreciation on Plant, Machinery, Furniture, Fixtures, Fittings and Exhibition Accessories (No provision has been made for depreciation on Freehold Properties)	9,712
8,919	Loss on Sale of Plant	7,538
1,370	Staff Pension and Assurance Scheme	2,834
600	Debenture Trustees' Fees	600
262	Audit Fee	262
3,000	Directors' Fees	3,025
3,312	Expenditure on improvements	4,705
158,667	Balance, carried down	156,437
<u>£176,130</u>		<u>£185,113</u>
48,000	First Mortgage Debenture Stock Interest Gross	46,578
	Provision for Taxation on the Profit for the year, after allowing for relief of £28,000 (£3,500 in 1949) in respect of Deferred Repairs provided in 1949 and Initial Allowances:	
63,941	Income Tax (Schedules A and D)	£32,250
—	Profits Tax	6,000
		<u>38,250</u>
—	Provision for Maintenance Equalisation	10,000
46,726	Balance, carried down	61,609
<u>£158,667</u>		<u>£156,437</u>
months) 15,583	Preference Dividend, less Income Tax	23,198
9,350	Provision for Ordinary Dividend of 4%, less Income Tax	8,925
15,000	Appropriation to Special Reserve	15,600
5,000	Appropriation to General Reserve	—
—	Appropriation to Dividend Equalisation Reserve	15,000
67,625	Balance unappropriated carried to Balance Sheet	66,511
<u>£112,558</u>		<u>£129,234</u>

STATEMENT PURSUANT TO PART II OF SCHEDULE 8 OF THE COMPANIES ACT, 1948

As neither of the Company's Subsidiary Companies are now trading, Group Accounts have not been prepared in view of the insignificant amounts involved. No profits or losses have been made and consequently no such profits or losses have required to be dealt with in this Company's Accounts, either in 1950 or in other years.

LIMITED

year ended 31st December, 1950

1949		£
	Net Profit after charging Management and Administration Expenses, subject to items set out contra (<i>Deferred Repairs provided in 1949,</i>	
174,388	£42,300)	183,214
42	Interest on Trade Investments <i>Gross</i>	42
121	Transfer Fees	105
1,579	Bank and Other Interest Receivable <i>Gross</i>	1,752
£176,130		£185,113
158,667	Balance, brought down	156,437
£158,667		£156,437
46,726	Balance, brought down	61,609
49,689	Balance, unappropriated as at 31st December, 1949	67,625
16,143	<i>Surplus on Taxation Reserves no longer required</i>	—
£112,558		£129,234

GESTETNER LIMITED. Balance

I. NET ASSETS

	£	£	1949 £
FIXED ASSETS			
Freehold Land and Buildings, Leasehold Premises, Plant and Machinery, Furniture Fixtures and Fittings, and Motor Vehicles. At cost, less the aggregate amount provided for depreciation (see Schedule, page 10) ..	307,272		231,690
Patents and Goodwill at cost, less amounts written off ..	1		1
	—	307,273	231,691
SUBSIDIARY COMPANIES			
Shareholdings at cost, less amounts written off ..	129,645		2,154
Amounts owing by Subsidiaries	561,503		429,205
	—	691,148	431,359
TRADE INVESTMENT			
At Cost		18,222	—
CURRENT ASSETS			
Stocks and Stores as valued by the Management ..	461,854		450,956
Debtors	438,599		381,393
Investments:			
Quoted on the London Stock Exchange ..			
Market Value £49,208 (1949 £48,913)	48,413		48,913
Sinking Fund and other Policies			
Surrender Value £62,142 (1948, £68,293)	58,289		65,547
Deposits with Building Societies and Others	115,000		255,000
Balances with Bankers and in Hand	234,646		281,019
		1,356,801	1,482,828
TOTAL ASSETS	£2,373,444		£2,145,878
CURRENT LIABILITIES			
Creditors and Accrued Charges	239,356		244,076
Taxation including Income Tax 1950-51 and Profits Tax to date	297,561		245,665
Proposed Final Ordinary Dividend (Net)	55,470		55,470
	592,387		545,211
PROVISION for Deferred Repairs and Renewals	6,256		12,411
		598,643	557,622
NET ASSETS	£1,774,801		£1,588,256

S. GESTETNER }
J. CLATWORTHY } Directors

NOTES:

1. Estimated further net refund of Excess Profits Tax for which no credit has been taken in these accounts amounts to £5,000 (1949, £6,000).
2. Estimated forward commitments for Capital Expenditure amount to £212,000 (1949, £74,232).

Sheet as at 31st August, 1950

II. MEMBERS' FUNDS

	£	£	1949 £ Issued	1949 £ Authorised
CAPITAL	Authorised	Issued		
7% Cumulative Preference Stock in 15/- units	262,500	262,500	262,500	262,500
Ordinary Stock in 5/- units	403,418	403,418	403,418	403,418
"A" Ordinary Stock in 5/- units	403,418	403,418	—	—
Unclassified Shares of 5/- each	930,664	—	—	334,082
	<u>£2,000,000</u>	<u>1,069,336</u>	<u>665,918</u>	<u>£1,000,000</u>
CAPITAL RESERVE		20,905	19,305	
REVENUE RESERVES AND UNAPPROPRIATED PROFITS				
General Reserve	175,000		468,418	
Specific Reserves:				
Profit reserved on goods manufactured, shipped to Subsidiaries and Stocking Agents and held in stock by them .. £256,882			218,264	
Estimated Future Liability for Income Tax 1952-52 on Profits earned to date.. .. . £220,000	476,882		185,000	
	<u>651,882</u>		<u>871,682</u>	
Profit and Loss Account balance carried forward	32,678		31,351	
		<u>684,560</u>	<u>903,033</u>	
TOTAL		<u>£1,774,801</u>	<u>£1,588,256</u>	

3. There is a contingent liability of £12,000 in respect of Bankers' revolving credit in London which Gestetner Limited has guaranteed to facilitate its export business.
4. These notes and those on pages 10 and 11 form an integral part of the Balance Sheet and Accounts. Movements on Reserves and Provisions (other than those shown on the face of the Accounts) are shown on pages 6 and 7.

GESTETNER LIMITED

Consolidated Balance Sheet

(See Note No. 3, page 11)

I. NET ASSETS			
	£	£	1949 £
FIXED ASSETS			
Freehold Land and Buildings, Leasehold Premises, Plant and Machinery, Furniture Fixtures and Fittings, and Motor Vehicles. At cost, less the aggregate amount provided for depreciation (see Schedule, page 10) ..	453,890		335,903
Patents and Goodwill at cost, less amounts written off ..	1		1
		453,891	335,904
SUBSIDIARY COMPANIES NOT CONSOLIDATED			
Shareholdings at cost, less amount written off	127,487		
Amounts owing	125,916	253,403	26,997
TRADE INVESTMENT			
At cost		18,222	—
CURRENT ASSETS			
Stocks and Stores as valued by the Management ..	792,320		790,407
Debtors	774,966		636,758
Investments:			
Quoted on the London Stock Exchange			
Market value £49,208 (1949, £48,913)	48,413		48,913
Sinking Fund and other Policies			
Surrender value £62,142 (1949, £68,293)	58,289		65,547
Deposits with Building Societies and Others	115,000		255,000
Balances with Bankers and in Hand	480,774		453,828
		2,269,762	2,250,453
Net Balance on Inter-Company Accounts due to Consolidation of Balance Sheets at different dates (see Note No. 9, page 11)		4,462	60,356
TOTAL ASSETS		£2,999,740	£2,673,710
CURRENT LIABILITIES			
Creditors and Accrued Charges	340,233		326,959
U.K. Taxation including Income Tax, 1950-51 and Profits Tax to date	353,985		304,834
Dominion and Foreign Taxes	88,830		105,979
Proposed Final Ordinary Dividend (Net)	55,470		55,470
	838,518		793,242
PROVISION for Deferred Repairs and Renewals	6,256		12,411
		844,774	805,653
NET ASSETS		£2,154,966	£1,868,057

AND SUBSIDIARIES

as at 31st August, 1950

(See Note No. 3, page 11)

II. MEMBERS' FUNDS

	£	£	1949 £ Issued	1949 £ Authorised
Authorised	Issued			
CAPITAL OF GESTETNER LIMITED				
7% Cumulative Preference Stock in 15/- units	262,500	262,500	262,500	262,500
Ordinary Stock in 5/- units	403,418	403,418	403,418	403,418
"A" Ordinary Stock in 5/- units	403,418	403,418	—	—
Unclassified Shares of 5/- each	930,664	—	—	334,082
	<u>£2,000,000</u>	<u>1,069,336</u>	<u>665,918</u>	<u>£1,000,000</u>
CAPITAL RESERVES				
Gestetner Limited	20,905		19,305	
Subsidiaries including Consolidation Reserve (see Note No. 4, page 11)	181,334		157,041	
		202,239	176,346	
REVENUE RESERVES AND UNAPPROPRIATED PROFITS				
General Reserve	232,029		494,124	
Specific Reserves:				
Profit reserved on goods manufactured, shipped to Subsidiaries not Consolidated and Stocking Agents and held in stock by them	£139,234		94,314	
Estimated future Liability for U.K. Income Tax 1951-52 on Profits earned to date	£220,000	359,234	185,000	
		591,263	773,438	
Profit and Loss Account balances carried forward	291,636		251,823	
		882,899	1,025,261	
TOTAL		<u>2,154,474</u>	<u>1,867,525</u>	

III. OUTSIDE SHAREHOLDERS INTEREST

Capital held and interest in the undistributed profits of Subsidiaries

492	532
<u>£2,154,966</u>	<u>£1,868,057</u>

GESTETNER LIMITED AND SUBSIDIARIES

Consolidated Balance Sheet as at 31st August, 1950

(See Note No. 3, page 11)

IV. MOVEMENTS ON RESERVES AND PROVISIONS

1. AMOUNTS CREDITED TO CAPITAL RESERVE:—

Gestetner Limited at 31st August, 1949 ..	19,305	
Add Profit upon Maturity of Sinking Fund and other Policies	100	
Add Amount realised on Sale of Leasehold Property	1,500	<u>£20,905</u>

2. AMOUNTS CREDITED TO REVENUE RESERVES:—

(a) Profit reserved on goods manufactured, shipped to Subsidiaries and Stocking Agents and held in stock by them at 31st August, 1949	218,264	
Add amount withdrawn from Profit on Trading of Gestetner Limited to cover increased Stocks at 31st August, 1950	38,618	

Amount of Reserve at 31st August, 1950

256,882

Deduct Proportion in respect of Consolidated Subsidiaries (Amount at 31st August, 1949, £123,950) ..

117,648

Amount of Reserve at 31st August, 1950, per Consolidated Balance Sheet

£139,234

(b) Estimated future Liability for Income

Tax on Profits earned to date:—

Balance at 31st August, 1949 ..	£185,000
Less Transferred to Current Liabilities	<u>£185,000</u>

Amount charged to Profit and Loss Account at 31st August, 1950 ..

£220,000

3. PROVISIONS FOR DEFERRED REPAIRS AND RENEWALS:—

Balance at 31st August, 1949	12,411
Deduct: Work executed during year to 31st August, 1950	9,215

3,196

Add: amount withdrawn from Profit on Trading of Gestetner Limited to cover cover additional work unexecuted at 31st August, 1950

3,060

£6,256

GESTETNER LIMITED

Profit and Loss Account for the year ended 31st August, 1950

		1949	
	£	£	£
PROFIT ON TRADING		655,300	551,254
Income from Quoted Investments ..	1,539		4,197
Income from other Investments and Deposits	1,241		1,481
(Interest on Tax Reserve Certificates)	—		687
Contributions received towards Experimental work	1,200		2,150
		3,980	8,515
Recoveries in respect of amounts written off in earlier years, after deduction of taxation thereon		703	2,493
		659,983	562,262
Less—			
Provision for Depreciation (see Note No. 1, page 10)	111,796		90,049
Contributions to Staff Endowment Insurance and Provident Scheme ..	18,019		14,566
Expenses of Bonus Share Capital Issue (Amount required to write down the book value of Quoted Investments to Market Prices)	5,994		—
	—		1,537
		135,809	106,152
PROFIT BEFORE TAXATION		524,174	456,110
Deduct: Estimated Taxation:			
Income Tax on Year's Profit including 1951-52 Liability	224,536		189,221
Profits Tax on Year's Profit	95,000		78,000
		319,536	267,221
NET PROFIT FOR THE PERIOD		£204,638	£188,889

GESTETNER LIMITED AND SUBSIDIARIES

Consolidated Profit and Loss Account for the year
ended 31st August, 1950

(See Note No. 3, page 11)

		1949	
	£	£	£
PROFIT ON TRADING		847,123	779,271
Income from Quoted Investments	1,539		4,197
Income from other Investments and Deposits	1,241		1,772
(Interest on Tax Reserve Certificates)	—		687
Contributions received towards Experimental Work	1,200		2,150
		3,980	8,806
Recoveries in respect of amounts written off in earlier years, after deduction of taxation thereon		703	3,262
		851,806	791,339
Less—Provision for Depreciation	151,848		121,410
Contributions to Staff Endowment Insurance and Provident Scheme	39,308		30,879
Expenses of Bonus Share Capital Issue	5,994		—
(Amount required to write down the book value of Quoted Investments to Market Prices)	—		1,537
		197,150	153,826
PROFIT BEFORE TAXATION		654,656	637,513
Deduct: Estimated Taxation			
Gestetner Limited (see page 7)	319,536		267,221
Subsidiaries:—			
U.K. Income Tax on Profits of Subsidiaries	2,891		27,000
U.K. Profits Tax on Profits of Subsidiaries	364		6,750
Dominion and Foreign Taxes	64,468		74,977
		387,259	375,888
PROFIT AFTER TAXATION		267,397	261,625
Outside Shareholders' Interest in Profits and Losses of Sub- sidiaries		(minus) 10	(add) 130
NET PROFIT FOR THE YEAR		267,387	261,755
Less Gestetner Limited		204,638	188,889
NET PROFIT OF SUBSIDIARIES RETAINED BY THEM (see Note No. 8, page 11)		£62,749	£72,866
Statement of Directors' Emoluments etc. Pursuant to Section 196 of the Companies Act, 1948			
Fees		£1,800	£1,800
Emoluments arising from Executive and Managerial Appointments:			
Gestetner Limited	31,026		32,260
Subsidiary Company	£15,519	46,545	12,817
		£48,345	£46,877
Pension from Gestetner Limited to a Director in respect of past services in a Managerial Capacity		£1,500	£1,500

GESTETNER LIMITED AND SUBSIDIARIES

Appropriation of Profits for the year ended 31st August, 1950

I. GESTETNER LIMITED						1949
		£	£			£
NET PROFIT FOR THE YEAR			204,638			188,889
Balance brought forward from previous period			31,351			34,191
			<u>235,989</u>			<u>223,080</u>
DIVIDENDS NET						
7 per cent. on Preference Stock <i>less</i> tax	10,106					10,106
On Ordinary Stock:						
Interim 6½ per cent. <i>less</i> tax	27,735					27,735
Final Proposed 8½ per cent. plus bonus 3½ per cent. <i>less</i> tax	55,470					55,470
			<u>93,311</u>			<u>93,311</u>
BALANCE AFTER DIVIDENDS			142,678			129,769
TRANSFER TO REVENUE (GENERAL) RESERVE			110,000			98,418
			<u>32,678</u>			<u>31,351</u>
BALANCE CARRIED FORWARD						
II. SUBSIDIARIES						
NET PROFIT FOR THE YEAR			62,749			72,866
EXCHANGE SURPLUS			31,323			—
Balances brought forward from previous periods			220,472			148,451
Outside Shareholders' Interests acquired in respect of Previous Years			30			—
			<u>314,574</u>			<u>221,317</u>
TRANSFERS TO RESERVES						
Capital Reserve	24,293					—
Revenue (General) Reserve	31,323					845
			<u>55,616</u>			<u>845</u>
BALANCE CARRIED FORWARD			258,958			220,472
Add Gestetner Limited			32,678			31,351
			<u>£291,636</u>			<u>£251,823</u>
Per Consolidated Balance Sheet						

GESTETNER LIMITED AND SUBSIDIARIES

Schedule of Fixed Assets

	1950		1949	
	£	£	£	£
GESTETNER LIMITED				
Freehold Land and Buildings at cost	268,014		202,679	
Less Depreciation	111,208	156,806	84,731	117,948
Leasehold Premises at cost	52,940		22,839	
Less Depreciation	27,939	25,001	22,838	1
Plant and Machinery at cost	361,173		312,146	
Less Depreciation	235,710	125,463	198,407	113,739
Furniture, Fixtures and Fittings at cost ..	82,721		61,910	
Less Depreciation	82,720	1	61,909	1
Motor Vehicles at cost	59,447		47,960	
Less Depreciation	59,446	1	47,959	1
		<u>£307,272</u>		<u>£231,690</u>
SUBSIDIARY COMPANIES CONSOLIDATED				
Freehold Land and Buildings at cost	85,640		39,630	
Less Depreciation	3,800	81,840	1,538	38,092
Leasehold Premises at cost	1,837		1,365	
Less Depreciation	866	971	546	819
Plant and Machinery at cost	29,294		25,601	
Less Depreciation	16,291	13,003	11,561	14,040
Furniture, Fixtures and Fittings at cost ..	48,700		40,607	
Less Depreciation	38,061	10,639	32,007	8,600
Motor Vehicles at cost	102,402		86,257	
Less Depreciation	62,237	40,165	43,595	42,662
		<u>£146,618</u>		<u>£104,213</u>
TOTAL (see CONSOLIDATED BALANCE SHEET)		<u>£453,890</u>		<u>£335,903</u>

Notes to Accounts

GESTETNER LIMITED'S ACCOUNTS

1. The year's provision for depreciation £111,796 (1949, £90,049) includes:

- £33,570 (1949, £21,856) being the net expenditure during the year on Furniture, Fixtures and Fittings, and Motor Vehicles written off in order to maintain the net value of each of those classes of asset at £1 and
- in the case of Plant and Machinery £22,946 (1949, £15,326) being the equivalent of the Initial Allowance due under the Income Tax Act, 1945 and Finance Act, 1949.

CONSOLIDATED ACCOUNTS

2. The Directors are of opinion that the preparation of the Consolidated Accounts would be unreasonably delayed if all the Subsidiary Companies' financial years ended with that of Gestetner Limited. They consider it undesirable, having regard to taxation and the laws governing these Companies abroad, to amend the financial years of the Subsidiary Companies to coincide with that of the Parent Company.

3. The Consolidated Balance Sheet incorporates the Balance Sheet of Gestetner Limited as at 31st August, 1950 and the Balance Sheets of ten Subsidiaries made up to various dates between 31st March, 1950, and 31st August, 1950. The Consolidated Profit and Loss Account incorporates the trading results of eight Subsidiaries for a period of 12 months ended on the date of their respective Balance Sheets and of two Subsidiaries incorporated during the year. In the case of two further Subsidiaries formed during the year, no Accounts have yet been prepared.
4. "Consolidation Reserve" represents amounts written off the cost of Consolidated Subsidiaries' shares in past years and the appropriate proportion of their profits capitalised by the issue of bonus shares.
5. In the case of certain Subsidiaries brought into the Consolidation, their audited accounts, whilst complying with the requirements of the laws of the respective countries concerned, do not comply with the requirements of the United Kingdom Companies Act, and adjustments have been made for the purpose of Consolidation.
6. The Accounts of certain Subsidiaries which are registered in countries abroad where there is no free currency exchange with Great Britain, have not been dealt with in the group accounts, as the Directors are of opinion that such consolidation would involve expense and delay out of proportion to the value to members of the Company and would convey no accurate picture.

The earliest and latest closing dates of the Financial years of these Companies are 31st December, 1949, and 30th June, 1950.

The net aggregate of such Subsidiaries profits less their losses, after local taxation as far as can be ascertained, and as prepared from records received by the Company and checked by their own staff but not audited or certified by the Company's auditors, so far as the members of this Company are concerned, were:—

<i>In respect of financial years of Subsidiaries Ended in year ended 31.8.50.</i>			
		<i>Other years (at rates ruling at at 31.8.49.)</i>	<i>Total (at rates ruling at 31.8.50)</i>
(i) Dealt with in this Company's accounts for the year to 31st August, 1950	Nil	Nil	Nil
(ii) Not dealt with in this Company's accounts for the year to 31st August, 1950	£44,785	£50,382	£95,167

7. Currency items in respect of Consolidated Subsidiaries have been converted as follows:—
 - (a) Fixed Assets at the approximate rates ruling when acquired.
 - (b) Current Assets and Liabilities at the rate ruling at 31st August, 1950.
8. Profits retained by the Subsidiaries are subject in certain cases to U.K. Taxation, less the Appropriate Double Taxation Relief (where applicable) when distributed.
9. The "Net debit balance on Inter-Company Accounts due to Consolidation of Balance Sheets at different dates" is the excess of the value of goods shipped to various Subsidiaries over their cash remittances during the period intervening between the dates of their Balance Sheets and that of Gestetner Limited.

JANTZEN (AUSTRALIA) LIMITED

Balance Sheet at 31st March, 1950

(Showing corresponding figures at 31st March, 1949)

1949 £		1950 £	£
SHAREHOLDERS' FUNDS—			
	CAPITAL (in Shares of £1 each):	Authorised	Issued
25,000	35,000 9% Cumulative First Preference	35,000	25,000
100,000	100,000 5% Cumulative Second Preference	100,000	100,000
73,333	115,000 Ordinary	115,000	73,333
198,333		£250,000	198,333
RESERVES (used in the business):			
44,000	General	65,000	
7,000	Contingencies	15,000	
51,000			80,000
7,720	PROFIT AND LOSS		11,430
£257,053	Total Shareholders' Funds		£289,763
REPRESENTED BY—			
FIXED ASSETS:			
59,051	Land and Buildings	59,654	
71,795	Machinery and Equipment	89,164	
19,399	Furniture, Fittings and Motor Vehicles	23,102	
150,245	Total Cost	171,920	
64,922	Less: Provision for Depreciation	75,252	
85,323	Net Value of Fixed Assets		96,668
PATENTS, TRADE MARKS, ETC.:			
	At Cost	15,000	
10,000	Less: Amount written-off	5,000	10,000
95,323			106,668
CURRENT ASSETS:			
270,495	Inventories, at lower of Cost or Market Value	312,367	
	Accounts Receivable	151,592	
53,683	Less: Provision for Doubtful Debts and Dis- counts	6,018	145,574
386	Cash on Hand	441	
78	Deferred Charges	254	
324,642	Total Current Assets	458,636	
LESS CURRENT LIABILITIES:			
88,600	Bank Overdraft (Secured)	156,065	
30,107	Accounts Payable	55,933	
5,812	Accrued Expenses	7,724	
30,996	Provision for Income Tax	47,615	
	Provision for Dividends Payable—		
	First Preference Shares	562	
	Second Preference Shares	1,042	
7,397	Proposed Dividend on Ordinary Shares	6,600	8,204
162,912	Total Current Liabilities	275,541	
161,730			183,095
£257,053			£289,763

W. A. FREEMAN }
CLIFFORD FRANCIS } Directors.

(This Balance Sheet is reproduced in simplified form on page 229.)

FISONS LIMITED

REPORT OF THE DIRECTORS

To be submitted to the Fifty-Seventh Annual General Meeting of the Company, to be held at the Registered Office, on Monday, December 4th, 1950, at 12 noon.

The Directors submit herewith their Fifty-Seventh Annual Report, with the Audited Statement of Accounts for the year ended 30th June, 1950.

PROFIT AND RECOMMENDATIONS.

The Consolidated Trading Profits of the Group for the year ended 30th June, 1950, after providing for the ordinary expenses of the business, amounted to £1,233,724 compared with £707,438.

Our sales of fertilisers in the United Kingdom have again increased, and in the opinion of the Directors this is largely responsible for the increased profit. There has, however, been a certain amount of stock piling by our customers in anticipation of the rise in price of fertilisers on July 1st, due to the partial removal of the Subsidy.

	£	£
The balance of profit available for appropriation (see Profit and Loss Account, pages 4 and 5) amount to		635,049
Out of which has been paid:		
Dividend on 4½% Cumulative Preference Stock	80,658	
Interim Dividend on Ordinary Stock, net ..	<u>73,236</u>	<u>153,894</u>
Leaving a balance available of		481,155
The Directors recommend this to be appropriated as follows:		
Transfer to General Reserve	132,201	
Transfer to Special Depreciation and Obsolescence Reserve	50,000	
Payment of a Final Dividend of 6%, less Income Tax, on the Ordinary Stock (making with the Interim Dividend already paid 9% for the year)	<u>146,472</u>	<u>328,673</u>
Leaving a balance to be carried forward to next year of		<u>£152,482</u>

DIVIDENDS.

Preference Stock.—The usual half-yearly dividends at the rate of 4½% per annum, less tax, on £3,258,900 Preference Stock were paid on the 30th September, 1949, and 31st March, 1950.

Ordinary Stock.—An Interim Dividend at the rate of 3%, less tax, was paid on £4,438,556 Ordinary Stock on 15th July, 1950.

The Directors now recommend the payment of a Final Dividend at the rate of 6%, less tax, on this stock in respect of the year ended 30th June, 1950, and it is proposed to pay this dividend on 12th December, 1950, to those Stockholders registered on the books on 22nd November, 1950.

DIRECTORS.

Under Article 96, Mr. A. Wormald, who has joined the Board since the last Meeting, retires, and being eligible, offers himself for re-election.

In accordance with Article 89 the following Directors retire by rotation:—

Mr. P. T. Chevallier, Mr. D. J. Bird, Mr. F. G. C. Fison, and being eligible, offer themselves for re-election.

AUDITORS.

The Auditors, Messrs. Price, Waterhouse & Co., have intimated their willingness to continue in office.

By Order of the Board,

K. RISDON PRENTICE,

Secretary.

Harvest House,
Ipswich.

9th November, 1950.

SUBSIDIARY COMPANIES

Corby Basic Slag, Limited
De Pass Fertilisers, Limited
George Hadfield & Company, Limited
George Johnson & Son (Silvertown), Limited
Nitrogen Fertilisers, Limited, Flixborough
British Chemicals & Biologicals (Pty.), Limited, Australia
British Chemicals & Biologicals (South Africa) (Pty.), Limited.
British Chemicals & Biologicals, Limited, controlling:—
Benger's, Limited Gland Supplies, Limited
Benger Laboratories, Limited Whiffen & Sons, Limited
Genatosan, Limited Zenobia, Limited

PRINCIPAL ASSOCIATED COMPANIES

					Extent of Fisons, Limited Share Interest therein
Albatros Fertilisers Inc., Maine, U.S.A.	..	..	..	..	50%
British & Continental Shipping Agency, Limited., London	..	..	..	..	50%
Fisons (Pty.), Limited, South Africa	..	..	..	..	50%
Fisons (Rhodesia), Limited, Rhodesia	..	..	..	..	50%
International Fertilisers, Limited, Canada	..	..	..	..	50%
Société Industrielle d'Acide Phosphorique et d'Engrais— Tunisia	..	..	..	..	20%

FISONS LIMITED

Consolidated Statement of Profit and Loss

Year to 30th June, 1949			Year to 30th June, 1950	
£	£		£	£
707,488		Trading Profits of Fisons, Limited and its Subsidiaries after taking account of the items shown inset below		1,333,724
269,297		Depreciation of Fixed Assets	348,804	
9,774		Auditors' Remuneration	10,083	
84,808		Pensions and Contributions to Pension Funds— Employees	90,518	
74,800		Directors' Emoluments, etc. (Note 1)	92,628	
—		Amount written off Investment in Associated Company	1,690	
—		Provision for Deferred Repairs	69,314	
		Add: Investment Income—Gross Associated Companies	17,309	
17,021	12,644	Government and Other Securities	87	17,396
	4,377			
734,459				1,351,030
	7,594	Deduct: Interest Charges Debenture Interest	37,042	
49,792	42,198	Bank interest and Acceptance Charges	45,246	82,288
674,667				
	250,777	Group Profits before deducting Taxation		1,168,732
426,387	176,210	Deduct: Taxation based on Profits of the year (Note 2)	305,123	
		Reserve for Future Income Tax in respect of relief from capital allowances (Note 3)	292,529	597,952
247,680				
26,041		Deduct: Net Profits applicable to Minority Interests in Subsidiaries		570,780
222,639				26,167
		Balance of Net Profit of the Group		544,623
20,321 Dr.		Deduct: Profits of Subsidiaries not dealt with in Accounts of the Holding Company		50,188
242,960				
	115,032	Balance of Net Profit of Fisons, Limited		494,435
163,379	43,347	Add: Balance brought forward from 30th June, 1949	127,830	
		Over provision for Taxation in prior years now released	12,784	140,614
406,339				
		Available for Appropriation		635,049
		Deduct: Transfers to Reserves:— General	132,201	
20,864		Special Depreciation and Obsolescence	50,000	182,201
	80,658	Dividends less Income Tax on:— 4½% Cumulative Preference Stock	80,658	
	30,515	Ordinary Stock:— Interim Dividend of 3% paid 15th July, 1950	73,236	
278,509	146,472	Proposed Final Dividend of 6%	146,472	219,708
				300,366
				482,567
£127,530		Balance of Profit carried forward at 30th June, 1950, as shown by Balance Sheet of Fisons, Limited (page 6)		£152,482
NOTE:—				
SUBSIDIARIES—Group Proportion of Profit and Loss Balances:—		Year to 30th June		
Profits of Subsidiaries not dealt with in accounts of Holding Company:—		1949	1950	
per Consolidated Statement of Profit above		£	£	
Add: Overprovision for taxation in prior years released		20,321 Dr.	50,188	
Balance brought forward from previous year		11,809	976	
		2,103 Dr.	10,615 Dr.	
Deduct: Transfer to General Reserve		10,615 Dr.	40,549	
			48,665	
FISONS LIMITED—Balance of Profit carried forward, as above		10,615 Dr.	8,116 Dr.	
		127,830	152,482	
GROUP—Profit and Loss Balance as shown by Consolidated Balance Sheet (page 8)		£117,315	£144,366	

FISONS LIMITED

Consolidated Balance Sheet as at 30th June, 1950

1949		Authorised	Stock Issued	
£	£	£	£	£
	SHARE CAPITAL OF FISONS LIMITED			
	4½% Cumulative Preference Stock and Shares of £1 each	8,500,000	8,258,900	
	Ordinary Stock and Shares of £1 each	5,000,000	4,438,586	
5,478,178		£8,500,000		7,697,486
	RESERVES—			
	<i>Capital—</i>			
1,863,803	Share Premium Account (Note 4)		1,732,585	
435,779	Special Depreciation and Obsolescence		485,779	
2,299,582			2,218,364	
117,799	<i>Revenue—</i>			
	General (Note 6)		398,665	
176,210	Future Income Tax—in respect of relief obtained from capital allowances		468,709	
17,616	Income Tax, 1951/52		40,877	
117,215	Profit and Loss Balance		144,366	
428,840			952,610	
2,728,422				3,170,974
8,806,800				10,868,430
1,196,539				1,191,841
£9,403,139	MINORITY INTERESTS IN CAPITAL AND RESERVES OF SUBSIDIARIES			£12,060,071
	<i>Represented by—</i>			
	FIXED ASSETS—			
4,116,311	Land, Buildings, Plant, Machinery, etc., at net book amount at 30th June, 1948 (less disposals) or at cost		7,361,487	
280,511	Less: Depreciation since 30th June, 1948		629,840	
3,835,800			6,831,647	
2,473,313	Additions under Construction at cost		1,308,097	
6,309,113			7,989,744	
152,200	Less: Loan secured on certain Land and Buildings		182,200	
6,156,913				7,787,544
2,101,441	Goodwill, representing premium (net) on acquisition of shares in Subsidiaries, at cost			2,100,766
8,258,354				9,888,300
	INTERESTS IN ASSOCIATED COMPANIES—			
727,197	Shares at cost less £35,620 (1949 £32,000) written off		715,911	
125,778	Loan and Current Accounts		117,928	
80,864 Cr.	Less: Amounts owing		42,870	
772,111			75,058	
	NET CURRENT ASSETS—			790,969
3,189,878	Stocks		2,278,701	
2,268,946	Debtors and Prepayments		3,402,432	
125,478	Government and other quoted securities (£123,228 held by Trustees for Debenture Stockholders in 1949), Market Value £2,363		2,360	
169,022	Balance at Bank held for repayment of 4½% Debentures including premium thereon			
96,453	Balances at Banks and Cash in Hand		2,000,941	
5,851,777			7,679,324	
	Less: CURRENT LIABILITIES, PROVISIONS AND DIVIDENDS—			
1,956,768	Creditors and Accrued Expenses	1,797,794		
2,294,273	Amounts owing to Bankers	6,172		
169,022	Debenture Stockholders in respect of Debentures redeemable 30th June, 1949			
690,687	Provisions:			
85,966	Current Taxation	548,375		
78,819	Deferred Repairs	127,014		
	Past Service Pensions	74,878		
		748,267		
6,417	Dividends proposed and accrued:			
197,151	Subsidiaries—Outside Shareholders	6,417		
	Fisons Limited	239,872		
5,479,103		246,289	2,768,522	
372,674				4,880,802
9,403,139				15,560,071
	Deduct LOAN CAPITAL OF FISONS LIMITED			
	4½% First Mortgage Debenture Stock 1955/53, secured by a first charge on the assets of the Company			8,500,000
£9,403,139				£13,060,071

The Notes have not been reproduced except No. 4 (Share Premium Account) on page 128 and No. 7 (Fixed Assets) on page 38

DUNLOP GROUP CONSOLIDATED

PROFIT AND LOSS STATEMENT

(Incorporating Dunlop Rubber Company, Ltd. (p. 8) and Subsidiary Companies (p. 9))

for the year ended 31st December, 1950

1949				
£	STATEMENT OF PROFIT	£	£	
	I. Trading Profits, less Losses. (Note 1):—			
4,035,126	(a) Dunlop Rubber Co., Ltd. (see p. 8, Item I.)			5,049,795
5,369,696	(b) Subsidiary Companies (see p. 9, Item I.)			12,489,487
9,404,812	(c) Total			17,539,282
	II. Investment Income:—			
55,042	(a) Trade Investments	66,195		
20,996	(b) Other Investments	14,659		80,854
9,480,860	III. OPERATING PROFIT			17,620,116
	Add:			
194,499	IV. Exceptional Items, i.e., Surplus Provisions (£117,840) and Sundry Profits (£77,671) relating to previous years			194,811
9,675,349				17,815,027
	Less:			
3,059,373	V. (a) Provisions for Depreciation	8,754,947		
29,806	(b) Audit Fees	39,616		
235,898	(c) Interest on Debenture Stock and Loans	265,711		
22,277	(d) Guaranteed Preference Dividend	—		
3,347,354				4,060,974
6,327,995	VI. NET PROFIT			13,754,753
	VII. Amount received (less Income Tax) on account of claims for refund of Excess Profits Tax in respect of Companies previously in enemy and enemy occupied territories			—
750,000				
£7,077,995	VIII. AVAILABLE NET PROFIT			£13,754,753
	DISPOSAL OF PROFIT			
	IX. PROVISIONS FOR TAXATION (Note 2):—			
908,894	(a) Foreign			3,375,899
2,549,973	(b) United Kingdom			5,315,991
3,458,867				8,691,890
	X. APPROPRIATIONS IN SUBSIDIARY COMPANIES:—			
	(a) Minority Shareholders' proportion:—			
43,620	(1) Transfers to Reserves and Surplus	24,059		
326,703	(2) Dividends, less Income Tax where applicable	462,126		
370,323				486,185
	(b) Dunlop Rubber Co., Ltd., proportion:—			
5,346	(1) Transfers to Capital Reserves	24,462		
238,271	(2) Transfers to Revenue Reserves	303,415		
57,798	(3) Increases in Surplus carried forward	981,883		
301,415				1,259,760
	XI. APPROPRIATIONS IN DUNLOP RUBBER CO., LTD.:—			
2,000,000	(a) Transfers to Revenue Reserves	1,915,000		
206,250	(b) Preference Dividends for the year, less Income Tax	201,563		
691,599	(c) Proposed Ordinary Dividend for the year, less Income Tax	1,180,988		
49,541	(d) Increase in Surplus carried forward	19,597		
2,947,390				3,316,918
£7,077,995				£13,754,753

DUNLOP RUBBER COMPANY, LIMITED

PROFIT AND LOSS STATEMENT

for the year ended 31st December, 1950

1949 £		£	£
	STATEMENT OF PROFIT		
4,035,126	I. Trading Profit (Notes 3 and 4)		5,049,795
	II. Investment Income:—		
40,319	(a) Trade Investments	40,319	'
19,264	(b) Other Investments	10,984	
			51,303
4,094,709	III. OPERATING PROFIT		5,101,098
	Add:		
948,936	IV. Dividends and other Revenue from Subsidiary Companies (<i>see p. 9, Item VIII. (b) (5)</i>)		2,617,214
88,182	V. Exceptional Items, i.e., Surplus Provisions relating to previous years ..		3,296
5,131,827			7,721,608
	Less:		
338,590	VI. (a) Provision for Depreciation	982,667	
6,300	(b) Audit Fees	6,300	
220,178	(c) Interest on Debenture Stock and Loans	218,555	
22,277	(d) Guaranteed Preference Dividend	—	
1,187,345			1,207,522
3,994,482	VII. NET PROFIT		6,514,086
	VIII. Amount received (less Income Tax) on account of claims for refund of Excess Profits Tax in respect of Companies previously in enemy and enemy occupied territories		—
750,000			
£4,744,482	IX. AVAILABLE NET PROFIT		£6,514,086
	DISPOSAL OF PROFIT		
1,797,092	X. PROVISION FOR UNITED KINGDOM TAXATION (Note 5)		3,197,168
	XI. APPROPRIATIONS:—		
	(a) TRANSFER TO GENERAL RESERVE:—		
	(1) Special Transfer equivalent to estimated tax relief in respect of 1950 initial allowances of the Group	415,000	
360,000	(2) General Appropriation of Profits	1,500,000	
1,640,000			1,915,000
	(b) PREFERENCE DIVIDENDS:—		
306,250	For the year to 31st December, 1950, less Income Tax (already paid) ..	201,563	
	(c) ORDINARY DIVIDEND:—		
691,599	Proposed for the year to 31st December, 1950, less Income Tax ..	1,180,958	
49,541	(d) INCREASE IN SURPLUS CARRIED FORWARD	19,397	
2,947,390			3,316,918
£4,744,482			£8,514,086

SUBSIDIARY COMPANIES

PROFIT AND LOSS STATEMENT

for the year ended 31st December, 1950

1949 £	STATEMENT OF PROFIT	£	£
5,369,686	I. Trading Profits, less Losses		12,489,487
	II. Investment Income:—		
14,723	(a) Trade Investments	26,876	
1,732	(b) Other Investments	3,655	
			29,531
5,386,141	III. OPERATING PROFIT		12,519,018
	Add:		
106,317	IV. Exceptional Items, i.e., Surplus Provisions (£114,044) and Sundry Profits (£77,571) relating to previous years		191,615
5,492,458			12,710,633
	Less:		
2,170,783	V. (a) Provisions for Depreciation	2,772,380	
23,506	(b) Audit Fees	33,316	
15,720	(c) Interest on Debenture Stock and Loans	47,156	
2,210,009			2,852,752
£3,282,449	VI. AVAILABLE NET PROFIT		£9,857,881
	DISPOSAL OF PROFIT		
	VII. PROVISIONS FOR TAXATION:—		
908,894	(a) Foreign		3,375,899
752,881	(b) United Kingdom		2,118,823
1,661,775			5,494,722
	VIII. APPROPRIATIONS:—		
	(a) MINORITY SHAREHOLDERS' PROPORTION:		
43,620	(1) Transfers to Reserves and Surplus	24,059	
326,703	(2) Dividends, less Income Tax where applicable	462,136	
370,323			486,185
	(b) DUNLOP RUBBER CO., LTD., PROPORTION:		
5,346	(1) Transfers to Capital Reserves	24,462	
238,271	(2) Transfers to Revenue Reserves	303,416	
57,798	(3) Increases in Surplus carried forward	931,883	
301,415	(4) Total Transfers to Reserves and Surplus	1,259,760	
948,936	(5) Dividends and other Revenue accruing to Dunlop Rubber Co., Ltd. (see p. 3, Item IV)	2,617,214	
1,250,351			3,876,974
£3,282,449			£9,857,881

DUNLOP GROUP CONSOLI-

as at 31st

1949			
£		£	£
1,000,000	I. ISSUED SHARE CAPITAL OF DUNLOP RUBBER COMPANY, LIMITED:—		
1,000,000	1,000,000 64% "A" Cum. Pref. Shares of £1 each, fully paid	1,000,000	
2,400,000	1,000,000 7% "B" Cum. Pref. Shares of £1 each, fully paid	1,000,000	
8,333,023	3,000,000 10% "C" Cum. Pref. Shares of 16s. each, fully paid	2,400,000	
	£12,853,989 Ordinary Stock	12,853,989	
12,783,023			17,253,969
	II. RESERVES AND SURPLUS attributable to Dunlop Rubber Company, Limited:—		
	Capital Reserves:—	£	
1,076,106	(a) Share Premium Reserves	5,547,052	
580,502	(b) Excess Profits Tax Post-War Refund Suspense Account	572,509	
45,283	(c) Other Capital Reserves (Note 8)	1,629,290	
1,701,891			7,748,851
	Revenue Reserves:—		
15,386,831	(d) General Reserves (Note 9)	17,421,756	
2,138,841	(e) Surplus (Note 10)	3,447,182	
17,574,672			20,868,938
19,276,563			28,617,789
	III. INTEREST OF MINORITY SHAREHOLDERS in Subsidiary Companies:—		
8,919,996	(a) Shares	8,920,350	
584,613	(b) Reserves and Surplus (including Capital Reserves, £12,535)	709,761	
9,504,599			9,629,111
	IV. DEBENTURE STOCK AND LOANS:—		
5,713,908	(a) Dunlop Rubber Co., Ltd., secured Debenture Stock	5,597,108	
399,711	(b) Subsidiary Companies' secured Debentures, and Loans	1,844,202	
6,107,619			6,941,310
	V. FUTURE INCOME TAX		
2,169,289	Estimated 1961-62 Liability, payable in 1962		4,424,045
	VI. CURRENT LIABILITIES AND PROVISIONS:—		
8,049,170	(a) Sundry Creditors and Accrued Liabilities	12,518,386	
199,377	(b) Bills Payable	4,569,820	
4,830,590	(c) Bank Loans and Overdrafts (Note 11)	2,284,512	
3,398,868	(d) Sundry Provisions (Note 12)	5,017,438	
5,856,708	(e) Taxation Payable in 1961	7,856,984	
	(f) Proposed Dividends, less Income Tax where applicable:—		
794,724	Dunlop Rubber Co., Ltd.—Dividends	1,279,895	
143,442	Dividends of Subsidiaries to Minority Shareholders	194,148	
23,072,879			33,520,683
	VII. EXCHANGE SUSPENSE ACCOUNTS:—		
96,369	Being amounts reserved for unrealised exchange differences		187,771
£73,010,341			£100,594,878

DATED BALANCE SHEET

December, 1950

1949 £		£	£
	I. FIXED ASSETS at Cost, less Depreciation or Amortisation:— (Note 13)		
9,028,422	(a) Land and Buildings	10,496,521	
2,039,060	(b) Rubber Estates	2,040,567	
9,560,297	(c) Plant, Machinery and Equipment	10,985,326	
661,299	(d) Patents, Trade Marks, Licences and Royalty Agreements	661,300	
<u>21,279,078</u>			24,183,714
	II. INVESTMENTS at Cost, less Amounts written off:—		
673,680	(a) Trade Investments	900,419	
132,054	(b) Other Investments not quoted	10,768	
633,528	(c) Investments in Subsidiaries not consolidated	—	
<u>1,439,242</u>			911,187
	III. CURRENT ASSETS:—		
28,347,562	(a) Inventories at or below Cost	40,015,731	
13,229,783	(b) Sundry Debtors, Bills Receivable, etc., less Provisions	20,362,586	
425,534	(c) Deferred Charges	468,754	
29,958	(d) Marketable Securities (Market value, 31st December, 1950, £127,728)	116,264	
2,250,000	(e) U.K. Tax Reserve Certificates	760,000	
4,131,633	(f) Bank Balances and Cash	11,843,126	
<u>48,414,470</u>			73,546,461
	IV. GOODWILL ACCOUNTS—including the net difference between the value at which inter-company holdings of shares are taken as assets into the Balance Sheets, and their par values, less undistributed profits at the date of acquisition of such shares (Note 14)		1,863,316
<u>1,877,551</u>			

£73,010,341£100,624,678CLIVE BAILLIEU, *Chairman.*G. E. BEHARRELL, *Deputy Chairman & Managing Director.*JOHN H. LORD, *Director of Finance.*

DUNLOP RUBBER COMPANY

as at 31st

1949		Authorised (as last year)	Issued (fully paid)	
£		£	£	£
I. SHARE CAPITAL:—				
1,000,000	1,000,000 6½% "A" Cumulative Preference Shares of £1 each ..	1,000,000	1,000,000	
1,000,000	1,000,000 7% "B" Cumulative Preference Shares of £1 each ..	1,000,000	1,000,000	
2,400,000	3,000,000 10% "C" Cumulative Preference Shares of 16s. each ..	2,400,000	2,400,000	
8,883,023	£15,600,000 Ordinary Stock	15,600,000	12,853,969	
12,783,023		£20,000,000		17,253,969
II. RESERVES AND SURPLUS:—				
<i>Capital Reserves:—</i>				
782,358	(a) Share Premium Reserve (<i>Note 18</i>)	5,253,302		
227,196	(b) Excess Profits Tax Post-War Refund Suspense Account ..	227,391		
—	(c) Other Capital Reserves (<i>Note 19</i>)	1,460,278		
1,009,552			6,940,971	
<i>Revenue Reserves:—</i>				
13,398,665	(d) General Reserve (<i>Note 20</i>)	14,997,582		
1,440,562	(e) Surplus	1,459,959		
14,839,227			16,457,541	
15,848,779				23,398,512
III. DEBENTURE STOCK secured as a first charge upon the Assets of the Company:—				
	3½% Debenture Stock		6,000,000	
5,713,908	Less Redeemed		402,892	
				5,597,108
IV. AMOUNTS OWING TO SUBSIDIARY COMPANIES:—				
1,866,640	Advances and Current Accounts (<i>less</i> dividends since declared) ..			2,747,751
V. FUTURE INCOME TAX:—				
1,375,000	Estimated 1951/52 Liability, payable in 1952			2,350,000
VI. CURRENT LIABILITIES AND PROVISIONS:—				
2,965,741	(a) Sundry Creditors and Accrued Liabilities		4,478,962	
199,377	(b) Bills Payable		1,235,082	
588,474	(c) Bank Loan (<i>Note 21</i>)		610,269	
1,186,201	(d) Sundry Provisions (<i>Note 22</i>)		1,477,065	
3,720,000	(e) Taxation—Balances payable in 1951		3,840,000	
	(f) Proposed Dividends, <i>less</i> Income Tax:—			
103,125	Preference Dividends for half-year to 31st December, 1950 (<i>since paid</i>) ..		98,437	
691,599	Ordinary Dividend for the year to 31st December, 1950		1,180,958	
9,454,517				12,920,773
£47,041,867				£64,268,113

LIMITED BALANCE SHEET

December, 1950

1949 £		£	£
	I. FIXED ASSETS at Cost, <i>less</i> Depreciation (<i>Note 23</i>):—		
1,797,778	(a) Freehold Land and Buildings	1,818,687	
219,971	(b) Leasehold Premises	379,593	
3,461,106	(c) Plant, Machinery and Equipment	3,856,338	
638,323	(d) Patents, Trade Marks, Licences and Royalty Agreements	638,323	
<u>6,117,178</u>			6,792,911
	II. INVESTMENTS AND ADVANCES, at Cost, including Bonus Shares at Par Value, <i>less</i> Amounts written off and Provisions:—		
9,827,753	(a) Subsidiary Companies (<i>Note 24</i>):—		
	(1) Shares	11,243,869	
12,359,196	(2) Advances and Current Accounts (including dividends since since declared)	17,225,764	
<u>22,186,949</u>		28,469,633	
649,220	(b) Trade Investments	854,433	
<u>22,836,169</u>			29,324,066
	III. CURRENT ASSETS:—		
9,156,610	(a) Inventories at or below cost, as certified by the Company's Officials ..	16,083,438	
4,518,961	(b) Sundry Debtors and Claims, <i>less</i> Provisions	5,399,680	
89,253	(c) Deferred Charges	108,518	
110,321	(d) Leasehold Redemption Policy at Surrender Value	117,188	
138,255	(e) Bills Receivable	218,461	
2,250,000	(f) Tax Reserve Certificates	750,000	
1,825,120	(g) Bank Balances and Cash	5,478,861	
<u>18,088,520</u>			28,161,146
<u>£47,041,867</u>			<u>£64,368,113</u>

CLIVE BAILLIEU, *Chairman.*G. E. BEHARRELL, *Deputy Chairman and Managing Director.*JOHN H. LORD, *Director of Finance.*

Notes on the Accounts (pp. 7-13)

DUNLOP GROUP CONSOLIDATED PROFIT AND LOSS STATEMENT (page 7).

1. (a) The trading results of the Subsidiary Companies in Germany and Japan for 1950 are included in the Consolidated Profit and Loss Account.

- (b) The trading profits shown are after charging Capital Issue expenses of:—

Dunlop Rubber Co., Ltd.	..	..	..	..	£	196,846
Subsidiary Company	..	..	..	..	£	58,010
						<u>£254,856</u>

2. Provisions for Taxation:

Taxation on the Profits of the Year:—

(a) Foreign, including adjustments for previous years	..	..	..			£	3,375,899
(b) United Kingdom:—							
(1) Profits Tax, 1950	..	..	..	..	£	2,018,406	
Less Relief for Foreign Taxation	..	..	..	..	£	562,442	
							1,455,964
(2) Income Tax, 1951/52	..	..	..	..	£	4,433,534	
Less Relief for Foreign Taxation	..	..	..	..	£	806,470	
							4,127,064
							5,583,028
(3) Less: Adjustments for previous years	..	..	..	..		267,037	
							<u>5,315,991</u>
							<u>£8,691,890</u>

DUNLOP RUBBER COMPANY, LIMITED, PROFIT AND LOSS STATEMENT (page 8).

3. The trading profit shown is after charging Capital Issue Expenses of £196,846.

4. Directors' Emoluments have been charged as follows:—	1949			1950		
	Fees	Management Emoluments	Total	Fees	Management Emoluments	Total
Gross Payments	£21,400	£110,806	£131,706	£21,400	£127,641	£149,041
Deduct: Paid by Subsidiary Companies	400	31,275	31,675	400	31,275	31,675
Paid by Parent Company	<u>£21,000</u>	<u>£79,031</u>	<u>£100,031</u>	<u>£21,000</u>	<u>£96,366</u>	<u>£117,366</u>
5. Provisions for United Kingdom Taxation:						
Taxation on the Profits of the Year:—					£	£
(a) Profits Tax, 1950	..	..	..	..	1,182,381	
Less: Relief for Foreign Taxation	..	..	..	..	62,853	
						1,119,479
(b) Income Tax, 1951/52	..	..	..	..	2,278,628	
Less: Relief for Foreign Taxation	..	..	..	..	117,809	
						2,260,819
						3,380,298
Less: Adjustments for previous years	..	..	..	..	..	183,130
						<u>£3,197,168</u>

DUNLOP GROUP CONSOLIDATED BALANCE SHEET (pages 10 and 11).

6. The Assets and Liabilities of the Subsidiary Companies in Germany and Japan are included in the 1950 Consolidated Balance Sheet under their respective headings.

7. Foreign Currencies have been dealt with as follows:—

- (a) Fixed and Current Assets of Foreign Subsidiary Companies, to the extent of the amount of the Parent Company's Investments, are included at the cost in sterling when the Investments or Advances were made (less amounts written off and provisions).

- (b) All other items have been converted at rates ruling at 31st December, 1950.

8. Other Capital Reserves

	Dunlop Rubber Co., Ltd. proportion	Minority proportion	Total
Balance at 31st December, 1949	£45,283	8,704	£54,047
Add: (a) Transfer from General Reserve in respect of Bonus Shares issued by Subsidiary Companies (see Note 9 (e))	1,460,278	—	1,460,278
(b) Miscellaneous Transfers, net (including opening balances of Subsidiary Companies now consolidated)	99,267	36	99,303
(c) Profit and Loss Account Appropriations	24,462	2,735	28,197
Balance at 31st December, 1950	<u>£1,629,290</u>	<u>£12,535</u>	<u>£1,641,825</u>

9. General Reserves:

	Dunlop Rubber Co., Ltd. proportion	Minority proportion	Total
Balance at 31st December, 1949	£ 15,355,831	£ 554,150	£ 15,909,981
Add: (a) War Damage Compensation	109,718	98,595	208,313
(b) Miscellaneous Transfers, net	37,773	1,448	39,220
(c) Profit and Loss Account Appropriations	2,215,415	35,478	2,250,893
(d) Credits arising from German Subsidiary Company, now consolidated	1,130,298	—	1,130,298
	18,882,034	689,671	19,571,705
Deduct: (e) Transfer to Other Capital Reserves (see Note 8 (a))	1,460,278	—	1,460,278
Balance at 31st December, 1950	£ 17,421,756	£ 689,671	£ 18,111,427

10. Surplus:

	Dunlop Rubber Co., Ltd. proportion	Minority proportion	Total
Balance at 31st December, 1949	£ 2,188,841	£ 21,699	£ 2,210,540
Opening balances of Subsidiary Companies now consolidated	307,061	10	307,071
Increase/Decrease per Profit and Loss Statement	951,280	15,154	966,436
Balance at 31st December, 1950	£ 3,447,182	£ 37,863	£ 3,485,045

11. In the case of certain Bank Loans and Overdrafts the Banks hold a floating charge on assets of the Companies concerned.

12. The increase in Sundry Provisions represents new provisions required and charged against the profit of 1950, less provisions applied during the year or no longer necessary and exchange adjustments.

13. Fixed Assets:

	31st December, 1949			31st December, 1950		
	Original Cost or Valuation	Depreciation or Amortisation to date	Net Book Value	Original Cost or Valuation	Depreciation or Amortisation to date	Net Book Value
Land and Buildings	£ 14,361,063	£ 5,332,641	£ 9,028,422	£ 16,660,016	£ 6,163,495	£ 10,496,521
Rubber Estates	3,931,188	1,892,128	2,039,060	4,132,534	2,091,967	2,040,567
Plant, Machinery and Equipment	28,329,685	18,779,388	9,550,297	32,488,115	21,502,789	10,985,326
	46,621,936	26,004,157	20,617,779	53,280,665	29,758,251	23,522,414
Patents, Trade Marks, etc.						
At Cost	84,993	62,019	22,974	84,993	62,019	22,974
At Net Book Value	—	—	638,325	—	—	638,326
Total as per Balance Sheet			£ 21,279,078			£ 24,183,714

14. Included in the figure of Goodwill are amounts of £19,933, Preliminary Expenses and £12,486, Discount on Debentures, both in respect of Subsidiary Companies.

15. Estimated outstanding Capital Commitments at 31st December, 1950, £3,350,000.

16. There are Contingent Liabilities, mainly for bills under discount, amounting to £506,081.

DUNLOP RUBBER COMPANY LIMITED, BALANCE SHEET (Pages 12 and 13).

17. Foreign Currencies have been dealt with as follows:—

- Investments in and Advances to Subsidiary Companies are included at the cost in sterling when the Investments and Advances were made (less amounts written off and provisions).
- Other Assets and Liabilities have been converted at rates ruling at 31st December, 1950.

18. The increase of £4,470,948 in the Share Premium Reserve arises from the issue during 1950 of 13,412,837 Ordinary Shares of 6s. 8d. each, at an issue price of 13s. 4d. each.

19. Other Capital Reserves:—

The amount of £1,460,278 arises by a transfer from General Reserve in respect of Bonus Issues by Subsidiary Companies to date (see Note 20(d)).

20. General Reserve:—

	£
Balance at 31st December, 1949	18,398,665
Add: (a) Miscellaneous Transfers, net	13,897
(b) Credits arising from reinstatement of investment in and issue of Bonus Shares by German Subsidiary Company	1,130,398
(c) Profit and Loss Account Appropriation	1,915,000
	<u>£16,467,860</u>
Deduct: (d) Transfer to Other Capital Reserves (see Note 19)	1,460,278
Balance at 31st December, 1950	<u>£14,997,582</u>

21. A Bank Loan of Canadian \$1,812,500 (£810,268) is secured on certain Assets of the Company.

22. The increase in Sundry Provisions represents new provisions required and charged against the profit of 1950 less provisions applied during the year or no longer necessary.

23. Fixed Assets:—

	31st December, 1949			31st December, 1950		
	Original Cost or Valuation	Depreciation to Date	Net Book Value	Original Cost or Valuation	Depreciation to Date	Net Book Value
Freehold Land and Buildings ..	£3,164,347	£1,866,569	£1,797,778	£3,375,874	£1,467,217	£1,918,657
Leasehold Premises	462,853	242,882	219,971	647,127	267,534	379,598
Plant, Machinery and Equipment ..	9,242,963	5,781,857	3,461,106	10,247,030	6,390,692	3,856,338
	<u>£12,870,163</u>	<u>£7,891,308</u>	<u>£4,788,855</u>	<u>£14,270,031</u>	<u>£8,115,443</u>	<u>£6,154,588</u>
Patents, Trade Marks, etc.: At Net Book Value			638,323			638,323
Total as per Balance Sheet			<u>£5,117,178</u>			<u>£6,792,911</u>

24. The Shares in and Loan to the American Subsidiary Company have been placed at the disposal of H.M. Treasury under the provisions of the Financial Powers (U.S.A. Securities) Act, 1941.

25. The Company has guaranteed:—

(a) The Preference Shares as to Capital, Premium and Dividend of:—

Dunlop Planations Limited, Issued Amount	£2,500,000
Dunlop Cotton Mills Limited, Issued Amount	£2,250,000
Dunlop Rubber Company (India) Limited, Issued Amount	Rupees 30,00,000

(b) Bank Advances to certain Subsidiary Companies and Agents.

27. Estimated Outstanding Capital Commitments at 31st December, 1950, £825,000.

27. There are Contingent Liabilities for bills under discount amounting to £837,203.

COMPARATIVE RESULTS. 1942-1950

	1942	1943	1944	1945	1946	1947	1948	1949	1950
CONSOLIDATED PROFIT.									
I. THE AGGREGATE OPERATING PROFIT OF Dunlop Rubber Co., Ltd., and Subsidiary Companies	£ 6,639,637	£ 6,469,271	£ 6,143,244	£ 6,346,279	£ 8,034,967	£ 9,116,933	£ 10,768,376	£ 9,480,860	£ 17,630,116
II. EXCEPTIONAL ITEMS not attributable to the current year	79,641	30,045	84,395	465,454	149,057	134,515	192,100	194,499	194,911
III. TOTAL PROFIT	£ 6,719,278	£ 6,499,316	£ 6,227,539	£ 6,811,733	£ 8,184,024	£ 9,251,448	£ 10,960,476	£ 9,675,359	£ 17,815,027
IV. FROM THIS PROFIT THERE HAS BEEN DEDUCTED:—									
(a) Depreciation	967,691	969,416	1,013,930	1,347,560	1,915,551	2,169,148	2,538,969	3,059,373	3,754,947
(b) Audit Fees	13,537	13,582	14,065	15,017	19,833	23,749	24,011	29,806	39,616
(c) Interest on Debenture Stock and Loans	129,657	126,415	126,086	135,708	172,972	248,438	238,207	235,898	265,711
(d) Guaranteed Preference Dividends of Subsidiary Companies paid by Dunlop Rubber Co., Ltd.	75,000	75,000	75,000	75,000	82,500	82,500	82,500	82,500	82,500
V. LEAVING THE NET PROFIT	£ 4,433,293	£ 5,319,603	£ 4,998,458	£ 5,224,648	£ 5,993,168	£ 6,727,623	£ 8,086,789	£ 6,327,995	£ 13,764,763
VI. ADD: Refund (less Income Tax) on account of Excess Profits	—	—	—	—	1,000,000	760,000	—	760,000	—
Tax claims	—	—	—	—	—	—	—	—	—
VII. TOTAL	£ 4,433,293	£ 5,319,603	£ 4,998,458	£ 5,224,648	£ 6,993,168	£ 7,477,623	£ 8,086,789	£ 7,077,995	£ 13,764,763
APPROPRIATIONS									
I. PROVISION FOR TAXATION:—									
(a) Foreign	765,011	835,949	999,842	1,197,918	1,598,798	1,288,263	1,291,222	908,894	2,376,899
(b) United Kingdom	2,668,175	3,424,301	2,900,269	2,065,643	2,237,640	2,602,761	3,036,585	2,549,973	5,315,991
(c) Total	3,437,186	4,259,250	3,900,111	3,263,461	3,836,438	3,841,004	4,327,807	3,458,867	8,692,890
II. PAID TO SHAREHOLDERS OF SUBSIDIARY COMPANIES ATTRIBUTABLE TO MINORITY SHAREHOLDERS	171,287	151,830	155,247	172,262	239,311	331,205	256,387	370,323	486,185
III. UNDISTRIBUTED PROFITS ATTRIBUTABLE TO DUNLOP RUBBER COMPANY, LIMITED	294,215	346,225	385,996	1,032,695	2,043,695	2,421,690	2,675,746	2,340,966	2,194,157
IV. DIVIDENDS PAID BY DUNLOP RUBBER COMPANY, LIMITED	540,205	565,298	557,104	756,330	893,734	893,734	897,849	897,849	1,382,521
V. Total	£ 4,433,293	£ 5,319,603	£ 4,998,458	£ 5,224,648	£ 6,993,168	£ 7,477,623	£ 8,086,789	£ 7,077,995	£ 13,764,763
NET WORKING CAPITAL.									
SURPLUS OF CURRENT ASSETS OVER CURRENT LIABILITIES	£ 14,784,176	£ 16,848,718	£ 16,573,982	£ 18,517,269	£ 21,611,461	£ 24,024,269	£ 24,385,027	£ 25,341,391	£ 40,028,778
MINORITY SHAREHOLDERS' CAPITAL EMPLOYED (including Undistributed Profits)	£ 5,966,152	£ 5,978,573	£ 5,990,508	£ 7,257,090	£ 7,174,974	£ 8,749,307	£ 9,930,304	£ 9,504,999	£ 9,699,111
DUNLOP ORDINARY SHARE CAPITAL	8,333,023	8,333,023	8,333,023	8,333,023	8,333,023	8,333,023	8,333,023	8,333,023	12,853,969
II. GROUP SURPLUS AND RESERVES ATTRIBUTABLE TO DUNLOP ORDINARY SHAREHOLDERS:—									
(a) Capital Reserves	787,610	787,639	787,639	1,042,572	1,862,124	1,860,228	1,767,477	1,701,891	7,748,451
(b) Revenue Reserves	5,956,602	6,224,235	6,224,235	6,224,235	7,330,787	7,330,787	15,029,999	17,674,672	20,868,958
(c) Total	6,794,212	7,011,874	7,308,341	8,683,359	11,338,059	13,890,160	16,797,476	19,376,563	28,617,789
III. ORDINARY SHAREHOLDERS' CAPITAL EMPLOYED (including Undistributed Profits)	£ 16,067,235	£ 16,344,897	£ 16,641,364	£ 16,916,382	£ 19,718,083	£ 22,223,203	£ 25,180,499	£ 27,859,586	£ 41,471,768
DIVIDEND RATES, including Bonus (subject to Income Tax).									
I. RATE PAID ON ISSUED ORDINARY SHARE CAPITAL	8%	8%	8%	12%	15%	15%	15%	15%	17½%
II. EQUIVALENT RATE ON ORDINARY SHAREHOLDERS' CAPITAL EMPLOYED	4.4	4.3	4.3	5.9	6.3	6.6	6.0	4.5	8.4

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